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Supreme Court, U.S.
FILED

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No. _____ OFFICE OF THE CLERK

In The

# Supreme Court of the United States

October Term, 1997

CITY AND COUNTY OF HONOLULU,

*Cross-Petitioner,*

vs.

SMALL LANDOWNERS OF OAHU, AND RICHARD S. H. WONG, OSWALD K. STENDER, MARION M. L. LINDSEY, GERARD A. JERVIS, AND HENRY H. PETERS, in their capacities as Trustees of The Kamehameha Schools Bernice Pauahi Bishop Estate,

*Cross-Respondents.*

**On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit**

## CONDITIONAL CROSS-PETITION FOR WRIT OF CERTIORARI PURSUANT TO RULE 12.5


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94 pp

## QUESTION PRESENTED

Whether a rent control ordinance, which applies to long term leases containing multiple rent adjustments and assures lessors a reasonable rate of return by authorizing rent increases consistent with increases in the consumer price index, substantially advances a legitimate governmental interest and is therefore not a taking under the Fifth Amendment of the United States Constitution as applied to the states through the Fourteenth Amendment.

## LIST OF PARTIES

The parties to the proceeding before the United States Court of Appeals for the Ninth Circuit whose judgment is sought to be reviewed herein are as follows:

City and County of Honolulu

Hale Coalition

Gerard A. Jervis, as Trustee of The Kamehameha Schools Bernice Pauahi Bishop Estate

Marion M. L. Lindsey, as Trustee of The Kamehameha Schools Bernice Pauahi Bishop Estate

Henry H. Peters, as Trustee of The Kamehameha Schools Bernice Pauahi Bishop Estate

William S. Richardson, as Trustee of The Kamehameha Schools Bernice Pauahi Bishop Estate

Small Landowners of Oahu

Oswald K. Stender, as Trustee of The Kamehameha Schools Bernice Pauahi Bishop Estate

Matsuo Takabuki, as Trustee of The Kamehameha Schools Bernice Pauahi Bishop Estate

Myron B. Thompson, as Trustee of The Kamehameha Schools Bernice Pauahi Bishop Estate

Richard S. H. Wong, as Trustee of The Kamehameha Schools Bernice Pauahi Bishop Estate

## RULE 29.6 STATEMENT

Pursuant to Rule 29.6 of the Rules of this Court, Cross-Petitioner City and County of Honolulu states that The City and County of Honolulu is a governmental subdivision of the State of Hawaii and has no parent or non-wholly owned subsidiaries.

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## CONDITIONAL CROSS-PETITION FOR WRIT OF CERTIORARI PURSUANT TO SUPREME COURT RULE 12.5

Pursuant to Rule 12.5 of the Rules of this Court, the City and County of Honolulu hereby conditionally Cross Petitions this Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit.

## OPINIONS BELOW

The opinion of the court of appeals is reported at 124 F.3d 1150 (9th Cir. 1997) and is attached in the Appendix (pages 1a-40a) to the Petition for Writ of Certiorari filed herein by the Bishop Estate and Small Landowners of Hawaii (hereafter "Pet. App."). The orders denying rehearing and rehearing *en banc* are reproduced at Pet. App. 100a-102a. The opinion of the district court is reported at 802 F. Supp. 326 (D. Haw. 1992) and is reproduced at Pet. App. 41a-82a. The final judgment of the district court is reproduced at Pet. App. 103a.

## CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Fifth Amendment of the United States Constitution provides "nor shall private property be taken for public use without just compensation."

## STATEMENT OF THE CASE

In 1991, the City Council of the City and County of Honolulu enacted legislation to address a serious problem relating to the housing of the City's citizens. Approximately 65% to 70% of the condominium units within the City had been developed and marketed "leasehold." This meant that the "buyers" of these condominium units actually received long term leases providing for groundrents to be periodically adjusted to market levels and for the condominiums to revert to the lessors at the conclusion of the leases. By 1991, rent provisions of many of these leases were beginning to "re-open" resulting in dramatic rent increases. The rent increases highlighted public policy concerns for Honolulu's housing supply which would intensify over time as rents continued to increase while the remaining lease terms continued to decrease. The City Council's findings included the following:

> Testimony has been presented to the council that owner-occupants of condominium apartments were not informed of the terms and conditions of lease rent renegotiation provisions of their leases. Additionally, the terms and conditions of the lease, including the rent and renegotiation provisions, did not result from negotiations between lessors and individual owner-occupants, but instead were established unilaterally by the lessors. . . .
>
> From and after 1990, the lease rents for a substantial portion of the condominium housing units on leased land are due for renegotiation;

Testimony has been presented to the council that one condominium in Honolulu, the Sandalwood, has experienced lease rent increases of over 1,000 percent at the time of rent renegotiation and that similar increases will affect owner-occupants of other condominiums in the City and County. Unless controlled, the renegotiated lease rents may be unaffordable to many owner-occupants of leased condominium housing units . . .

The increases in the value of land have caused lease rentals to increase on renegotiation of rentals (on expiration of 25 to 30 years of initial fixed rent periods) to 1,000 percent, for renegotiated lease rentals are invariably tied to the fee simple value of the land on which the leasehold residential apartments are situated, and these new lease rentals have at times exceeded the amount of the payments that the lessee had been making on the leasehold mortgages;

The uncertainty associated with the expected high increases in lease rentals at the time of rent renegotiation have adverse economic impact on the marketability of such apartments since financing institutions are reluctant to give long-term mortgages to prospective buyers of such apartments; and

Residential leaseholds have also undesirable social effects. Lease rent negotiations are usually scheduled every 10 to 15 years after the initial fixed rent period of 25 to 30 years. Thus, as the lessee advances in age and the lessee's income potential declines, the lessee's lease rentals increase, causing the lessee to give up the lease

> and to look for other accommodations. This situation aggravates the already acute need for government-sponsored low and middle income and elderly housing. With the increasing number of elderly in this county, the problem promises to become even more acute in the foreseeable future, and will adversely affect the health and welfare of these people and the general welfare of the people of the City and County of Honolulu.

(Cond. Cross-Petition Appendix (CCP Appx. at A2).)

The Honolulu City Council chose to respond to these problems of escalating and unpredictable rents with legislative measures that have been recognized as appropriate, lawful and constitutional. One measure adopted by the City Council was a rent control measure. Ordinance 91-96 provided for a fair return to the lessors by permitting rents to increase at same level as increases in the consumer price index, plus any additional administrative increases necessary to assure a fair return to the lessors based on the individual circumstances of each lessor's operating costs.

The District Court held Ordinance 91-96 unconstitutional on the alternate grounds that (1) the ordinance did not provide for the new rents to be based on the numerous unique factors that could affect the value of the land "such as the rate of development in surrounding areas, which may affect the value of an individual parcel of real property at the time of renegotiation" (Pet. App. at 58a); and (2) the fact that the lessee's rent-controlled lease may have more value than a lease with no rent control. The Ninth Circuit Court of Appeals also held Ordinance

91-96 unconstitutional. Its decision focused on the second point raised in the District Court's decision:

> Land use regulations do influence the value of property, but to be constitutional, they must do so in a manner that substantially furthers a legitimate government interest. . . . The absence of a mechanism that prevents lessees from capturing the net present value of the reduced land rent in the form of a premium, means that the Ordinance will not substantially further its goal of creating affordable owner-occupied housing in Honolulu. Incumbent owner occupants who sell to those who intend to occupy the apartment will charge a premium for the benefit of living in a rent controlled condominium. The price of housing ultimately will remain the same. The Ordinance thus effects a regulatory taking.

Pet. App. 30a.

## REASONS FOR GRANTING THE PETITION

### A. The Ninth Circuit Court Of Appeals Substantially Departed From The Accepted Constitutional Standards Applicable To Price Control Regulations: A Price Control Law That Assures A Fair Rate Of Return Does Not Effect A Taking Merely Because It Also Bestows Economic Benefit On Purchasers Of The Price-Controlled Product

The Ninth Circuit Court of Appeals correctly identified the standard applicable to the Bishop Estate's challenge to Ordinance 91-96 as follows:

> A land use regulation, as noted above, does not effect a taking if it substantially furthers a legitimate state interest and does not deny the landowner economically viable use of his land.

Pet. App. 27a.

Furthermore, the Ninth Circuit did not question Ordinance 91-96's provisions which guarantee the lessors a reasonable rate of return by assuring that both rents and net operating incomes (to the extent that net operating incomes could be affected by operating costs) rise at the same level as the consumer price index. The constitutional standard requires, at most,[1] that the permitted rent increases preserve the lessor's right to a ***reasonable return on its investment***. *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 106 S. Ct. 1018, 1026-27, 89 L. Ed. 2d 166 (1986); *United States v. Riverside Bayview Homes, Inc.*, 474 U.S. 121, 106 S. Ct. 455, 460 n. 6, 88 L. Ed. 2d 419 (1985); *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1005, 104 S. Ct. 2862, 2875, 81 L. Ed. 2d 815 (1984); *Pruneyard Shopping Center v. Robins*, 447 U.S. 74, 83, 100 S. Ct. 2035, 2042, 64 L. Ed. 2d 741 (1980); *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104, 124-25, 98 S. Ct. 2646, 2659-60, 57 L. Ed. 2d 631 (1978).

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[1] Some courts have suggested that "reasonable return on investment" is more favorable to the landlord than required by the Constitution. For example, in *Rent Stabilization Assoc. v. Dinkins*, 805 F. Supp. 159, 163 (S.D. N.Y. 1992) *aff'd*, 5 F.3d 591 (2d Cir. 1993) the court dismissed the case for lack of standing, but indicated that the "reasonable return" standard may not be applicable in the Second Circuit and that rent might only be unconstitutional where the lessor can show that "the owner was precluded 'from realizing any profit whatsoever'."

The Ninth Circuit deviated from the established legal precedents regarding price controls when it invalidated Ordinance 91-95 which protects the seller's right to a fair rate of return merely because purchasers at the controlled price may profit. The Ninth Circuit found, without any evidence, that Ordinance 91-96 serves no legitimate state interest merely because the legislation may improve the resale market in which lessees may attempt to sell their leasehold condominium units. The Court of Appeals' conclusion, made as a matter of law and without any evidence whatsoever, that none of the ordinance's legitimate purposes could be advanced merely because the purchaser of a rent-controlled condominium unit might pay a higher price for the leasehold unit is not supportable.

As the Court of Appeals acknowledged, every land use regulation makes land more valuable for the benefitted property owner and less valuable for the burdened property owner. This is true of every price control regulation. Legislation which limits the price of natural gas to a reasonable return on investment obviously enables any manufacturer who uses natural gas to "monetize" the benefit of the regulated price through the profits made on the sale of the manufactured product. The Court of Appeals' holding that this monetary benefit to the purchaser of the regulated product effects a regulatory taking is unprecedented.

The Ninth Circuit's analysis failed to recognize that the government has a legitimate interest in facilitating a healthy and stable housing market. Ordinance 91-96 furthers this governmental interest by assuring lessees (who in many cases have paid hundreds of thousands of dollars for their leasehold homes) that they will not have their entire investments damaged or destroyed by rent

increases in excess of the general trend of prices and wages reflected in the consumer price index. Ordinance 91-96 furthers this interest while protecting the lessors' right to a fair return on investment. The express purposes of Ordinance 91-96 include:

> the establishment of maximum renegotiated lease rents for owner-occupied condominium housing units, with the provision of fair return to lessors, serves the public purpose of maintaining the affordability of housing for owner-occupants . . .
>
> The purpose of this Ordinance is to set maximum renegotiated lease rents which are affordable to condominium apartment owner occupants and fair to lessors.

Ordinance 91-96 accomplishes these purposes by benefitting both ***present lessees and future purchasers of leases over the entire terms of the leases***. It does so by providing a greater level of stability to ground-rents ***over the leases' entire terms***. By tying the rents to rises in wages and prices as reflected in the consumer price index, the legislation assures current and future lessees that they will not become homeless as the result of a "rent reopening" which re-sets rents at rates which are out of balance with the general trends reflected in the consumer price index.

Contrary to the Court of Appeals' conclusion, the legislation continues to serve its purposes after a leasehold condominium unit is sold by assuring future owner-occupants that they will not be rendered homeless by future rent adjustments which greatly exceed the consumer price index. The future lessees will be protected against excessive escalation in ground rents beyond the reasonable increases authorized in the ordinance. Because

the leases provide for repeated rent adjustments throughout the course of their terms, every purchaser of a condominium lease benefits from Ordinance 91-96's assurance that future rent adjustments will not exceed the general rise in prices reflected in the consumer price index.

The valid legislative purpose of providing reasonable, predictable rent increases and reasonable rates of return throughout the entire terms of the leases will continue to benefit every future owner-occupant assignee of the leases through their expiration. Ordinance 91-96 thus substantially advances the legitimate state interest for current and future lessors and lessees of:

> accommodating the conflicting interests of protecting tenants from burdensome rent increases while at the same time ensuring that landlords are guaranteed a ***fair return on their investment***. (emphasis added).

*Pennell v. San Jose*, 485 U.S. 1, 13 (1988). The Ninth Circuit erroneously jumped to the conclusion that no legislative purpose could be advanced by the ordinance.

In *Carson Harbor Village Ltd. v. City of Carson*, 37 F.3d 468 (9th Cir. 1994), the Ninth Circuit Court of Appeals recognized the government's legitimate interest of protecting present and future lessees' investments from being destroyed by dramatic rent increases. *Carson Harbor* involved a trailer park in which the lessees owned the trailers but rented the land on which the trailers were parked. The leases, like the leases in the instant case, were assignable and the lessor, in the context of a substantive due process challenge, made the same argument which was adopted by the Ninth Circuit in the instant

case: rather than serving a legitimate state interest, the rent control ordinance merely "grants a 'windfall' to tenants who sell." 37 F.3d at 472. However, the Ninth Circuit recognized that the ordinance could serve the legitimate state interest in controlling present and future rents:

> . . . we have no difficulty concluding that a rational legislator could have believed that the prohibition of rent increases at the termination of a tenancy would further the law's goals, at least insofar as the purpose is to protect the investments of existing tenants. . . .

*Id.*

Like the legislation in *Carson Harbor* and all other price control legislation, Ordinance 91-96 benefits buyers and burdens sellers. The Ninth Circuit Court of Appeals substantially deviated from the decisions of this Honorable Court, when it found that these benefits and burdens defeat all legitimate governmental purposes of price controls.

### B. The New Standard Created By The Ninth Circuit Court Of Appeals Departs From Existing Precedent By Improperly Substituting The Court's Opinion For That Of The City Council On The Economic Impacts Of Rent Control

The debate over the benefits of price regulations, including rent control, has existed as long as there have been politicians and economists. For generations, the various viewpoints on the effects of price controls have been debated at length before city councils, legislatures and every other conceivable legislative body. There are, of

course, numerous economists whose opinions parallel the opinion expressed by the Ninth Circuit – that rent control serves no legitimate purpose. Indeed, many conservative economists have concluded that rent control hurts the parties whom it is intended to help. Obviously, there are other experts who disagree.

Historically, the debate over the benefits of rent control legislation has been addressed to legislative bodies around the United States. The Ninth Circuit's approach would move the economic debate over the benefits of rent control out of the legislature and into the federal courts where district judges would be called upon to choose between the expert economists testifying for the landlords and those economists testifying for the tenants. The City and County of Honolulu submits that this is not the law. Furthermore, even if it were the law, the appropriate result would be remand to the District Court for a trial on the likely results of the rent control ordinance.

The City and County of Honolulu submits that *Dolan v. City of Tigard*, 512 U.S. 374 (1994) does not require any "heightened scrutiny" of Ordinance 91-96. *Dolan* was based on two factors not present in the instant case: (1) Unlike *Dolan*, which involved an "adjudicative decision to condition a petitioner's application for a building permit on an individual parcel", Ordinance 91-96 involved essentially legislative determinations classifying an entire class of property; and (2) unlike *Dolan*, Ordinance 91-95 does not involve the conditioning of any permits on a deed of property. These two factors are central to this Honorable Court's decision in *Dolan*, 512 U.S. at 385, and are not present in the instant case.

More importantly, even if the *Dolan* requirement of "rough proportionality" were required of Ordinance 91-95, the ordinance would pass that test. The legitimate governmental purpose – which was not challenged by the Ninth Circuit – of assuring present and future owner-occupant lessees that they will not have their homes jeopardized by rent adjustments dramatically in excess of the rate of increases of consumer prices is certainly proportionate with the reasonable limitations invoked by Ordinance 91-96.

## CONCLUSION

For the foregoing reasons, this Conditional Cross-Petition for Writ of Certiorari should be granted if the Petition for Writ of Certiorari is granted.

Respectfully submitted,

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# APPENDIX A

OFFICE OF THE CITY CLERK
CITY AND COUNTY OF HONOLULU
HONOLULU, HAWAII

**CERTIFICATE**

I hereby certify that attached hereto is a true and correct copy of the Ordinance No. 91-96 of the City and County of Honolulu, the original of which is on file and of record in this Office.

In Witness Whereof, I have hereunto set my hand and caused the Seal of the City and County of Honolulu to be affixed this day the 19th of December, 1991.

/s/ Raymond K. Pua
RAYMOND K. PUA
City Clerk

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ORDINANCE NO. **91-96** BILL NO. 36 (1991)
CD-2, FD-1

A BILL FOR AN ORDINANCE RELATING TO LEASE RENT.

BE IT ORDAINED by the People of the City and County of Honolulu:

SECTION 1. Findings and Purpose.

The council finds that:

(1) According to the *State of Hawaii Data Book 1990* by the Department of Business and Economic Development,

the City and County of Honolulu had within its jurisdiction in 1987:

(A) A total of 25,203 condominium housing units which were owner-occupied; and

(B) Of that total, 16,291 or approximately sixty-five percent were on leased land;

(2) No information has been presented to the council suggesting that the date under paragraph (1) has changed appreciably since 1987;

(3) Testimony has been presented to the council that owner-occupants of condominium apartments were not informed of the terms and conditions of lease rent renegotiation provisions of their leases. Additionally, the terms and conditions of the lease, including the rent and renegotiation provisions, did not result from negotiations between lessors and individual owner-occupants, but instead were established unilaterally by the lessors. Accordingly, it is reasonable to presume that the lessor was acting in its own best interest and established the lease rent according to the then prevailing market lease rents;

(4) From and after 1990, the lease rents for a substantial portion of the condominium housing units on leased land are due for renegotiation;

(5) Testimony has been presented to the council that one condominium in Honolulu, the Sandalwood, has experienced lease rent increases of over 1,000 percent at the time of rent renegotiation and that similar increases will affect owner-occupants of other condominiums in the City and County. Unless controlled, the renegotiated lease rents may be unaffordable to many owner-occupants of leased condominium housing units;

(6) If renegotiated lease rents become unaffordable, the owner-occupants may have no recourse but to terminate their leases or sell their leasehold interests and seek housing elsewhere; and

(7) Residential leaseholds have had and continue to have the following undesirable economic effects:

(A) The increases in the value of land have caused lease rentals to increase on renegotiation of rentals (on the expiration of 25 to 30 years of initial fixed rent periods) to 1,000 percent, for renegotiated lease rentals are invariably tied to the fee simple value of the land on which the leasehold residential apartments are situated, and these new lease rentals have at times exceeded the amount of the payments that the lessee had been making on the leasehold mortgages;

(B) Lease rent renegotiations have strongly favored the lessor, the lessee having little option but to consent to such rental as determined by the lessor or to give up the leasehold and home, although the lease may yet have 25 or more years to run;

(C) The inequality of bargaining power has allowed lessors to charge lease rent based not only on the raw land value of the property but also on the value of the offsite and onsite improvements which have already been paid for or will be paid for by the lessee and on the value accruing thereon;

(D) The uncertainty associated with the expected high increases in lease rentals at the time of rent renegotiation have adverse economic impact on the marketability of such apartments since financing institutions are reluctant to give

long-term mortgages to prospective buyers of such apartments; and

(E) Residential leaseholds have also undesirable social effects. Lease rent negotiations are usually scheduled every 10 to 15 years after the initial fixed rent period of 25 to 30 years. Thus, as the lessee advances in age and the lessee's income potential declines, the lessee's lease rentals increase, causing the lessee to give up the lease and to look for other accommodations. This situation aggravates the already acute need for government-sponsored low and middle income and elderly housing. With the increasing number of elderly in this county, the problem promises to become even more acute in the foreseeable future, and will adversely affect the health and welfare of these people and the general welfare of the people of the City and County of Honolulu.

The council further finds and declares:

(1) That the land is to be considered as a source of life, dignity, and economic freedom for the people who reside on it;

(2) That it is the policy of the City and County of Honolulu that the owner-occupant lessee of a residential apartment, so long as remaining a lessee, shall have the right to have rentals set at reasonable levels and to enjoy the owner-occupant lessee's leasehold estate under reasonable leasehold terms;

(3) That the increase in land value was not caused by the efforts of the lessors or the lessees and to allow lease rent increases to be based on the current land values would result in incredible hardship to lessees. Further, lease rent increases of 1,000 percent would make home ownership unaffordable to a

substantial number of owner-occupants of residential condominiums. In view of the already tight housing market in the City and County of Honolulu, such a result would be unconscionable. Accordingly, the council believes it is equitable to reform lease rent renegotiation provisions affecting residential condominiums so that the renegotiated lease rent is affordable to owner-occupant lessees while still providing a fair return to the lessors;

(4) Section 46-1.5(20), Hawaii Revised Statutes, authorized the City to regulate the "renting, subletting, and rental conditions of property for places of abode by ordinance," and section 46-1.5(13), Hawaii Revised Statutes, authorizes the City to "enact ordinances deemed necessary to protect health, life, and property, and preserve the order and security of the county and its inhabitants";

(5) Pursuant to the authority of section 46-1.5(20), the council adopted Ordinance 90-95, which imposed maximum renegotiated lease rents for condominium housing and certain other units;

(6) Ordinance 90-95 was invalidated by the United States District Court of the District of Hawaii in *Richardson v. City*, Civil No. 90-00856;

(7) The Court invalidated the Ordinance for, among other reasons, its broad application to more than "residential condominiums," which appear to mean owner-occupied condominium housing units and because the application of the rent cap formula to the "initial lease rent" (where the "initial lease rent" was the beginning lease rent) did not yield a reasonable return to the lessor;

(8) Unlike investor-owned or commercial apartments, owner-occupied condominium housing units are

intended for use as homes and not for business or income producing purposes;

(9) The initial lease rent in an apartment lease reflects the reasonable market value rent for that apartment on the effective date of said lease and, accordingly, increasing the initial lease rent by the percentage change in the consumer price index for Honolulu from the effective date of the lease to the renegotiation date results in affordable lease rents to apartment owner-occupants and reasonable returns to the lessor;

(10) Consequently, the establishment of maximum renegotiated lease rents for owner-occupied condominium housing units, with the provision of fair return to lessors, serves the public purpose of maintaining the affordability of housing for owner-occupants; and

(11) That the public health, safety, and welfare of the people of the City and County of Honolulu demand that this Ordinance be fully implemented and that other applicable laws be enacted, including legislation to prevent the imposition of confiscatory economic burdens upon the thousands of lessee apartment owners presently living on leased property.

The purpose of this Ordinance is to set maximum renegotiated lease rents which are affordable to condominium apartment owner-occupants and fair to lessors. This Ordinance is intended to be in conformance with *Richardson v. City*.

SECTION 2. The revised Ordinances of Honolulu 1978, as amended, is amended by adding a new chapter to be appropriately designated and to read as follows:

## "CHAPTER ___
## MAXIMUM ANNUAL RENEGOTIATED LEASE RENT

**Sec. ___ -1.1. Definitions.**

For the purposes of this chapter:

"Apartment," "association of apartment owners," "condominium," "declaration of horizontal property regime," and "declaration of condominium property regime" mean the same as defined under chapter 514A, Hawaii Revised Statutes.

"Apartment lease" means an apartment owner-occupant's lease for the owner-occupant's apartment and includes any lease to an apartment owner-occupant for the land upon which the owner-occupant's apartment is situated, including but not limited to a ground lease and/or a condominium conveyance document.

"Apartment owner" means a person holding, or the persons jointly or in common holding, a leasehold interest in a residential apartment.

"Apartment owner-occupant" is defined in section ___ -1.2.

"Condominium project" means a building containing at least one residential apartment.

"Consumer price index" means the Consumer Price Index For All Urban Consumers (CPI-U) for Honolulu published by the Bureau of Labor Statistics of the United States Department of Labor.

"Declaration" means a declaration of horizontal property regime or declaration of condominium property regime.

"Department" means the department of housing and community development.

"Fixed rent period" means the period of a lease during which the lease rent for a residential apartment is stated in the lease, even if the rent is not held constant for the entire period.

"Initial lease rent" means the beginning lease rent specified in an apartment lease or the reasonable market value rent prevailing at the effective date of the apartment lease determined as specified in section ___ -1.4, whichever is greater. This term specifically excludes any lease rents that reflect reduced rent at the beginning of the lease due to construction of the project or due to special negotiations between the developer and the land owner.

"Land owner" means the person holding the leased fee interest in the land on which a condominium project is situated.

"Lease" means a lease or master lease, including any sandwich interest, affecting a residential apartment. A sandwich interest means any lease or sublease in the chain of title between the land owner's interest in the land and the apartment lease.

"Lease rent" means the rent payable by a lessee to a lessor for the leasehold interest for a residential apartment under an apartment lease.

"Lessee" means any person to whom land on which a condominium project is situated is leased or subleased.

"Lessor" means any person who leases or subleases land on which a condominium project is situated.

"Maximum annual renegotiated lease rent," "maximum lease rent," or "maximum" means the maximum annual renegotiated lease rent applicable

to an apartment owner-occupant, as determined under section ___-1.5 or biennially adjusted under section ___-1.6.

"Renegotiated lease rent" means the lease rent determined in accordance with this chapter on the renegotiation dates specified in the lease.

"Renegotiated rent period" means any period of a lease following the expiration of the fixed rent period.

"Renegotiation date" means the date on which a renegotiated lease rent is to take effect.

"Residential apartment" means a condominium apartment which is used for residential purposes. The term does not include the following:

(1) An apartment used for commercial purposes;

(2) An apartment used as a time share unit or transient vacation unit, as defined under chapter 21A, article 9; or

(3) Any parking, recreational, or other nonresidential condominium apartments.

**Sec. ___-1.2. "Apartment Owner-Occupant"; Definition.**

(a) For the purpose of this chapter, an "apartment owner-occupant" or "owner-occupant" means an owner of a residential apartment who on the renegotiation date of the lease of the residential apartment occupies the residential apartment as the owner's principal residence.

(b) An apartment owner shall be deemed to occupy a residential apartment if, on the renegotiation date of the lease, the residential apartment serves as the principal

place of residence of the apartment owner and the apartment owner has possessory control of the premises at that time. An apartment owner shall not be deemed to have possessory control of the premises if the residential apartment is rented, leased, or otherwise assigned to another person or entity for any period of time. Proof of residency and possessory control shall be established by rules adopted by the department.

**Sec. ___-1.3. Applicability, Purpose of Chapter.**

(a) This chapter:

(1) Applies to all leases that contain provisions for renegotiation of lease rents for the residential apartment of an apartment owner-occupant. This chapter shall apply whether the leases were executed prior to the effective date of this chapter or are executed from the effective date of this chapter. This chapter also shall apply to lease rent renegotiations that are concluded after the effective date of this chapter;

(2) Sets a maximum annual renegotiated lease rent for the apartment of an owner-occupant;

(3) Allows the biennial adjustment of renegotiated lease rent during the renegotiated rent period;

(4) Allows the administrative adjustment of renegotiated lease rent for a residential apartment to an amount higher than the applicable maximum. Administrative adjustment is allowed when the lessor pays operating expenses for the apartment; and

(5) Establishes a process for certification that a renegotiated lease rent for the residential apartment of an apartment owner-occupant is within the maximum.

(b) This chapter does not and shall not be construed as setting a maximum lease rent or adjustment or certification process for lease rent payable during a fixed rent period or for a residential apartment that is not owned by an owner-occupant.

**Sec. ___-1.4. Renegotiation Provisions.**

(a) Every lease shall include or be deemed to include the following provisions:

(1) Renegotiation of lease rent shall occur no more frequently than every ten years from and after the rent renegotiation date; provided that the first renegotiation shall not be scheduled before the fifteenth year following the initial date of the lease;

(2) After any renegotiation, the renegotiated lease rent for the residential apartment of an apartment owner-occupant shall not exceed the maximum under section ___-1.5;

(3) During a renegotiated rent period, the renegotiated lease rent for a residential apartment may be further adjusted biennially in accordance with section ___-1.6; and

(4) The renegotiated lease rent for a residential apartment may exceed the applicable maximum if administratively adjusted pursuant to section ___-1.7.

(b) In the event the parties to an apartment lease are unable to reach agreement under any reopening provision, the department or its designee shall arbitrate, and the maximum lease rent as determined by arbitration shall be certified by the department as provided for in section ___-1.9; provided that where section 516D-12, Hawaii Revised Statutes, is applicable, the arbitration shall proceed pursuant to chapter 516D. Arbitration proceedings under this subsection will be subject to the following requirements:

(1) An advance deposit, which amount shall be determined by the department, equal to projected expenses and fees of the department or its designee for arbitration proceedings shall be required and shall be paid equally by lessors and lessees. All additional expenses and fees incurred by the department or its designee while acting as the arbitrator shall be borne equally by the lessees and the lessors. These additional expenses and fees shall be subject to monthly billings or other arrangements which may be specified by contract. If more than one lessee is involved in an arbitration proceeding, all lessees shall share equally in one-half of the arbitration costs. The same division of costs shall apply if more than one lessor is involved in a proceeding.

(2) Failure on the part of any lessee to comply with the provisions of this subsection, including failure to make advance deposits or payments, shall result in forfeiture of any rights or remedies under this chapter for arbitration, and the lessee's sole rights and remedies shall be as provided in the lease.

(3) If any lessor fails to comply with the provisions of this subsection, including failure to make advance deposits or payments, then arbitration proceedings under this chapter will cease and lease rent shall be set at the most recent fixed lease rent. Upon compliance with the provisions set forth herein, the arbitration may proceed, with the determination of the new lease rent effective from the date of compliance by the lessor.

**Sec. ___-1.5. Maximum Annual Renegotiated Lease Rent.**

(a) Except as otherwise specified under this subsection, the annual renegotiated lease rent payable from any renegotiation date by an owner-occupant for a residential apartment shall not exceed the maximum annual renegotiated lease rent established in accordance with this section. Only when administratively adjusted pursuant to section ___-1.7 may the annual renegotiated lease rent exceed the maximum.

(b) The maximum annual renegotiated lease rent for a residential apartment shall be the initial lease rent multiplied by a rent factor. The rent factor shall be determined by dividing:

(1) The average consumer price index for the six-month period in which the rent renegotiation occurs; by

(2) The average consumer price index for the six-month period in effect at the time of the effective date of the initial lease rent.

(c) For purposes of determining the maximum annual renegotiated lease rent, the applicable consumer

price index shall be the index in effect on the renegotiation date. The council is aware that the consumer price index is an average figure that is published every six months and may not accurately reflect the change in consumer prices as it applies to Honolulu on the renegotiation date. Accordingly, the maximum renegotiated lease rent may be adjusted within a six-month period to reflect the actual change, if any, and the adjusted amount shall be the maximum renegotiated lease rent for that period.

**Sec. ___-1.6. Biennial Adjustment of Renegotiated Lease Rent.**

(a) During a renegotiated rent period, the renegotiated lease rent for the residential apartment of an owner-occupant may be adjusted biennially by the lessor in accordance with this section. A lessor may, but is not required to, biennially adjust the lease rent for the residential apartment. If biennially adjusting the lease rent, the lessor may do so only with the approval of the department.

A renegotiated lease rent for a residential apartment, as adjusted in accordance with this section, shall be deemed within the applicable maximum.

(b) For the purpose of this section:

"Biennially adjusted lease rent" means the annual renegotiated lease rent, as biennially adjusted.

"Current lease rent" means the annual renegotiated lease rent in effect prior to a biennial adjustment.

"Effective date of the biennially adjusted lease rent" means the date on which a biennially adjusted lease rent takes effect. As provided under subsection (c), that date is two years after the effective date of the current lease rent.

(c) During a renegotiated rent period, the renegotiated lease rent for the residential apartment of an owner-occupant may be adjusted biennially. The biennially adjusted lease rent shall be determined by multiplying the current lease rent by a rent factor. The rent factor shall be determined by dividing:

(1) The average consumer price index for the six-month period encompassing the effective date of the biennially adjusted lease rent; by

(2) The average consumer price index for the six-month period encompassing the effective date of the current lease rent.

The biennially adjusted lease rent shall be effective from the date which is two years after the effective date of the current lease rent.

(d) When there is less than two years between the effective date of the current lease rent and the commencement of a new renegotiated rent period, the current lease rent shall not be biennially adjusted under this section.

(e) The council is aware that the consumer price index is an average figure that is published every six months and may not accurately reflect the change in consumer prices as it applies to Honolulu on the biennial adjustment date. Accordingly, the biennially adjusted lease rent may be revised within a six-month period after the official reporting of the applicable consumer price

index. The revision shall reflect the actual, official change, if any, in the consumer price index. The revised amount shall be the biennially adjusted lease rent in effect.

**Sec. ___-1.7. Administrative Adjustment Of Annual Renegotiated Lease Rent To Higher Than Maximum.**

(a) The annual renegotiated lease rent for the residential apartment of an owner-occupant may be adjusted by the department to an amount higher than the maximum applicable to that apartment. An administrative adjustment shall be made in accordance with this section and only for the circumstances of subsection (c) or (d).

(b) For the purpose of this section:

"Administratively adjusted lease rent" means the annual renegotiated lease rent, as administratively adjusted.

"Base year" means the last year of the fixed rent period.

"Base year net operating income" means the lessor's net operating income from the apartment during the base year. If the lessor shows that the net operating income from the apartment during the base year was lower than normal because of extraordinary or unusual expenses, the department may adjust the base year net operating income to reflect an appropriate amount.

"Fair net operating income" means net operating income from the apartment, as adjusted for inflation, which is the same as the base year net operating income.

Inflation shall be measured by the change in the consumer price index from the base year to the years for which the administrative adjustment is proposed.

"Operating expenses" mean:

(1) Common expenses assumed by the lessor and unpaid by apartment owners or other lessees of the condominium project;

(2) Expenses for services provided by the lessor which primarily benefit the apartment owners of the condominium project;

(3) Expenses for maintenance by the lessor of apartments or facilities of the condominium project;

(4) Real property taxes;

(5) Special or improvement district assessments imposed:

(A) By the State or City for the funding of public projects; and

(B) On the owner of the condominium project or land on which the condominium project is situated;

(6) Expenses for telephone, electricity, gas, water, sewer, or cable television services used by apartment owners;

(7) Expenses for rehabilitation or repair of apartments or other facilities of the condominium project; and

(8) Payments of debt service incurred for the construction of onsite or offsite improvements.

(A) "Offsite improvements" mean all physical improvements:

(i) Constructed or placed off the land on which the condominium project is situated; and

(ii) Which are to be used in common by occupants of all lands adjoining the improvements or by occupants of all lands for whose benefit the improvements have been constructed or placed; and

(B) "Onsite improvements" mean all physical improvements:

(i) Constructed or placed on the land on which the condominium project is situated; and

(ii) which are for the benefit of apartment owners and other lessees in the condominium project.

"Onsite improvements" include, but are not limited to, dwelling units, garages, stairs, walkways, driveways, walls, trees, shrubs, landscaping, and pools.

"Operating expenses for the apartment" mean operating expenses which:

(1) Are paid directly for the residential apartment; or

(2) Represent the proportionate share of the operating expenses attributable to the residential apartment, when the operating expenses are not paid directly for the apartment.

"Operating income from the apartment" means lease rent paid for the residential apartment.

"Net operating income" means operating income from the apartment less operating expenses for the apartment.

(c) The annual renegotiated lease rent for the residential apartment of an owner-occupant may be administratively adjusted to an amount higher than the maximum applicable to that apartment if:

(1) The lessor paid operating expenses for the apartment during the base year;

(2) The lessor paid those operating expenses exclusively from lease rent proceeds and not from separate charges;

(3) In the years for which the adjustment is proposed, the lessor will continue to pay those operating expenses exclusively from lease rent proceeds; and

(4) The lessor's net operating income from the apartment in the years for which the adjustment is proposed will be less than the lessor's base year net operating income.

The administratively adjusted lease rent for the residential apartment shall be set to maintain a fair net operating income to the lessor. The administratively adjusted lease rent shall be valid for as long as the lessor continues to pay the operating expenses for the residential apartment. When the lessor discontinues payment of all or a portion of the operating expenses, the administratively adjusted lease rent shall be readjusted by the lessor to reflect the discontinuation.

An administratively adjusted lease rent under this subsection may be biennially adjusted pursuant to section ___-1.6. The department shall establish a method of calculating the biennial adjustment to maintain the lessor's fair net operating income.

(d) The annual renegotiated lease rent for the residential apartment of an owner-occupant may be administratively adjusted to an amount higher than the maximum applicable to that apartment if:

(1) The lessor paid no operating expenses for the apartment during the last year of the fixed rent period;

(2) In the years for which the adjustment is proposed, the lessor will pay operating expenses for the apartment; and

(3) The lessor will pay those operating expenses exclusively from lease rent proceeds and not from separate charges.

The administratively adjusted lease rent for the residential apartment shall be set to allow the lessor to pass on the operating expenses to the apartment owner-occupant. The administratively adjusted lease rent shall be valid for as long as the lessor continues to pay the operating expenses for the residential apartment. When the lessor discontinues payment of all or a portion of the operating expenses, the administratively adjusted lease rent shall be readjusted by the lessor to reflect the discontinuation.

An administratively adjusted lease rent under this subsection may be biennially adjusted pursuant to section

___-1.6. The department shall establish a method of calculating the biennial adjustment to maintain the pass-on of the operating expenses.

(e) A lessor desiring an administrative adjustment of the annual renegotiated lease rent for a residential apartment shall petition the department. The petition shall specify the proposed adjusted lease rent and be accompanied by supporting data.

Upon receipt of a petition, the department:

(1) Shall review the proposed adjusted lease rent and supporting data;

(2) Shall give the lessor an opportunity to be heard;

(3) May conduct its own study of the lessor's operating income and operating expenses or appraisal of the residential apartment or condominium project; and

(4) May request the lessor to provide additional data.

Within ninety days of submission of the petition, the department shall approve, disapprove, or modify the proposed adjusted lease rent. Upon approval, disapproval, or modification, the department shall notify the lessor and owner-occupant of the residential apartment. From the effective date of the adjustment, the lessor may charge the administratively adjusted lease rent for the residential apartment.

If the department disapproves a proposed adjusted lease rent for the residential apartment, the lessor shall

not charge a lease rent higher than the maximum lease rent applicable to that apartment.

If the department does not take action within the ninety-day period, the proposed adjusted lease rent shall be deemed approved and effective on the ninety-first day following submission. The department shall notify the lessor and owner-occupant of the residential apartment.

(f) The department shall determine the cost incurred for each proceeding to adjust a lease rent. The lessor shall be charged for the cost incurred by the department for the proceeding; except that the lessor shall not be charged:

(1) For the cost of any study or appraisal undertaken by the department without the lessor's permission;

(2) If the department took no action on the proposed adjustment within the ninety-day period under subsection (e); or

(3) If the department waives the charge to prevent undue financial hardship on the lessor.

The department shall require the lessor to reimburse the department for the chargeable incurred costs, whether the proposed adjusted lease rent is approved, disapproved, or modified. All reimbursements received by the department shall be deposited into the general fund.

(g) The approval, disapproval, or modification of a proposed adjusted lease rent may be appealed by the lessor or apartment owner-occupant. An appeal shall be made in writing to the department within thirty days of the approval, disapproval, or modification.

An appeal shall not stay the administratively adjusted lease rent, as approved or modified by the department.

Upon the receipt of an appeal, the department shall refer the appeal to a hearing officer. The hearing officer shall:

(1) Hold an agency hearing in accordance with the contested case procedures of chapter 91, Hawaii Revised Statutes; and

(2) Issue a decision and order confirming, modifying, or disapproving the department's action.

The department may institute a civil action in any court of competent jurisdiction for the enforcement of a decision and order pursuant to this section.

**Sec. ___-1.8. Interest In Lease Rent Payments.**

The lessor, including the master lessor and any sandwich position, shall share in the receipt of lease rentals paid by the owner-occupants and other lessees, as adjusted by this section, in accordance with their respective interests. Notwithstanding any contrary provision in any contract or lease, a developer or other person entitled to share in the lease rent payments shall share in such lease rent payments by the owner-occupants and other lessees to the extent of the developer's or other person's interest as may be determined by agreement of those entitled to share in the payment of lease rentals by owner-occupants and other lessees, or in the absence of such agreement, pursuant to chapter 658, Hawaii Revised Statutes.

**Sec. ___-1.9. Certification Of Renegotiated Lease Rents After Renegotiation.**

(a) In the lease rent renegotiation process, the renegotiated lease rent for an apartment owner-occupant may be set by arbitration as provided in section ___-1.4(b) or by voluntary agreement without arbitration.

(b) Each renegotiated lease rent set by an arbitrator or by voluntary agreement without arbitration shall not exceed the applicable maximum.

(c) After being set by an arbitrator or voluntary agreement, but prior to taking effect, each renegotiated lease rent shall be submitted to the department. The purpose of the submission to the department is for certification that the renegotiated lease rent is within the applicable maximum. The apartment owner-occupant and lessor shall jointly submit the renegotiated lease rent. Upon submission, the department:

(1) May hold an agency hearing on the renegotiated lease rent;

(2) May require the apartment owner-occupant and lessor to submit relevant information; and

(3) May conduct its own study and investigation.

(d) The renegotiated lease rent shall be deemed within the maximum if:

(1) The department so certifies within thirty days of the submission of the renegotiated lease rent; or

(2) The department fails to issue a certification by the thirtieth day following the submission of the renegotiated lease rent.

If, within thirty days of submission, the department certifies that the renegotiated lease rent is not within the maximum, the renegotiated lease rent shall be invalid and shall not take effect. The department shall order the apartment owner-occupant and lessor to renegotiate again.

(e) A party aggrieved by the department's action or inaction under this section may appeal to the department. Upon receipt of an appeal, the department shall:

(1) Hold an agency hearing in accordance with the contested case procedures of chapter 91, Hawaii Revised Statutes; and

(2) Issue an appropriate decision and order.

(f) If a court of competent jurisdiction rules or the State attorney general or corporation counsel opines that a renegotiated lease rent set by an arbitrator may be vacated, modified, or corrected only pursuant to chapter 658, Hawaii Revised Statutes, and not by action of the department, an action to vacate, modify, or correct the renegotiated lease rent set by an arbitrator shall be subject to chapter 658, Hawaii Revised Statutes, and no appeal of the renegotiated lease rent set by an arbitrator shall be made to the department.

**Sec. ___-1.10. Assignment Of Renegotiated Lease Rent To Another Apartment Owner-Occupant.**

If, during a renegotiated rent period, an apartment owner-occupant conveys or transfers the leasehold interest in a residential apartment to another person intending to be an owner-occupant, the renegotiated lease rent for the residential apartment shall be assigned and applicable to the new owner-occupant. For the renegotiated lease rent to be so assignable, the new owner-occupant shall execute an affidavit stating that the new owner-occupant intends to occupy the apartment so long as owning the residential apartment.

**Sec. ___-1.11. Renegotiated Lease Rent Exceeding Maximum For New Apartment Owner-Occupant.**

When an apartment owner conveys or transfers the leasehold interest in a residential apartment to another person intending to be an owner-occupant and:

(1) The apartment is under lease during a renegotiated rent period; and

(2) The renegotiated lease rent for the apartment is greater than the applicable maximum;

the renegotiated lease rent for the apartment shall be reduced by the lessor to the maximum rent chargeable under this chapter and such reduction shall be effective as of the date of occupancy by the new owner-occupant. For the renegotiated lease rent to be so reduced, the new owner-occupant shall execute an affidavit stating that the

new owner-occupant intends to occupy the apartment as long as owning the apartment.

**Sec. ___-1.12. Renegotiated Lease Rent Of Apartment Owner Who Is No Longer Owner-Occupant.**

A lessor may reopen the renegotiated lease rent for the residential apartment of an apartment owner who:

(1) Was an owner-occupant of a residential apartment at the time of lease rent renegotiation; but

(2) No longer qualifies as an apartment owner-occupant.

If reopened, the renegotiated lease rent for the residential apartment shall be set in accordance with the lease agreement for persons who are not owner-occupants and shall be effective as of the date of disqualification as provided by this chapter.

**Sec. ___-1.13. Renegotiated Lease Rent Of New Apartment Owner Who Is Not An Owner-Occupant.**

A lessor may reopen the renegotiated lease rent for the residential apartment of an apartment owner when:

(1) The apartment owner has purchased or otherwise received the leasehold interest in a residential apartment from a former owner-occupant; and

(2) The apartment owner does not occupy the residential apartment.

If reopened, the renegotiated lease rent for the residential apartment shall be set in accordance with the lease agreement for persons who are not owner-occupants and shall be effective as of the date of conveyance to the new apartment owner.

**Sec. ___-1.14. Enforcement.**

(a) Any person violating any provision of this chapter shall be subject to a civil fine not exceeding $500 for each violation.

(b) The department shall enforce this chapter. Any person may request that the department investigate any alleged violation of any part hereof, or the department on its own initiative may investigate any alleged violation.

(c) Upon receipt of a written request by a person to investigate an alleged violation of this chapter, or upon its own initiative, the department shall conduct an investigation. If finding that a violation has occurred, the department shall attempt an informal correction of the violation. If the violation cannot be informally corrected or if the person requesting the investigation or the alleged violator requests an agency hearing, the department shall:

(1) Hold an agency hearing in accordance with the contested case procedures of chapter 91, Hawaii Revised Statutes; and

(2) Issue an appropriate decision and order. If finding that a violation has occurred, the department may order the violator to do any or all of the following:

(A) Cease and desist from the violation;

(B) Correct the violation;

(C) Pay to a lessor or lessee any amount due and owing as specified in this chapter. An "amount due and owing" includes excessive lease rent paid by an apartment owner-occupant or insufficient lease rent paid to a lessor; or

(D) Pay the civil fine imposed under subsection (a).

The department may institute a civil action in any court of competent jurisdiction for the enforcement of any decision and order issued pursuant to this section. If finding that a violation has not occurred, whether before or after an agency hearing, the department shall so notify the alleged violator and, if any, the person who requested the investigation. The notification shall be in writing."

SECTION 3. Chapter 13, article 53, Revised Ordinances of Honolulu 1978, as amended, is repealed.

SECTION 4. This Ordinance shall take effect upon its approval.

INTRODUCED BY:

Andy Mirikitani

Councilmembers

DATE OF INTRODUCTION:

April 3, 1991
Honolulu, Hawaii

APPROVED AS TO FORM AND LEGALITY:

_____
Deputy Corporation Counsel

APPROVED this ___ day of _____, 1991.

_____
FRANK F. FASI, Mayor
City and County of Honolulu

(@OCS/120391/rrec)

# APPENDIX B

**Leasehold Conversion of Condominiums and Cooperative Housing Projects Phase I**

[LOGO]

Prepared For:

Housing Finance and Development Corporation

Prepared By:
Ezra, O'Connor, Moon & Tam
DHM Planners Inc.
John Child & Co. Inc.
Peat Marwick Main & Co.

**November 1987**

EXHIBIT "CC"

# LEASEHOLD CONVERSION OF CONDOMINIUMS AND COOPERATIVE HOUSING PROJECTS PHASE I

Prepared for:
Housing Finance and Development Corporation

Prepared By:
Ezra, O'Connor, Moon & Tam
DHM Planners Inc.
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November 1987

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## INTRODUCTION

This study was prepared in response to 1987 House Resolution 380 (H.R. 380), "House Resolution requesting the Hawaii Housing Authority to address issues related to leasehold conversion of condominiums and cooperative housing projects." (See Appendix 1)

H.R. 380 requested answers to specific questions related to the property beneath condominiums and cooperative housing projects, and to report its findings to the Legislature 20 days prior to the convening of the 1988 Session.

In May 1987 the Housing Finance and Development Corporation (HFDC), formerly part of the Hawaii Housing Authority, sent out a Request for Proposal to fulfill the requirements of H.R. 380. The consultant team of Ezra, O'Connor, Moon and Tam; DHM Planners Inc.; John Child and Company Inc.; and Peat Marwick Main and Co. were selected to prepare the report.

H.R. 380 requested that interviews be conducted with individuals with varying interests in the lease to fee conversion issue. A list of the persons interviewed is contained in Appendix 2 of this report.

This report represents Phase I of the study and consists of (a) the findings of the interviews, (b) research on the leasehold conversion issue, (c) responses to questions in H.R. 380, and (d) conclusions and recommendations. HFDC grouped the questions into five different issue areas: General, Policy, Finance and Value, Legal and Tax. This report is organized according to this grouping.

## EXECUTIVE SUMMARY

### CONCLUSIONS/RECOMMENDATIONS

The research and findings of the interviews conducted as a part of this study indicate that there are primarily five areas of concern in the leasehold condominium and cooperative housing system. Proponents of mandatory conversion legislation have raised these five areas of concern as

objectives to be achieved by mandatory conversion legislation. They are:

1. Increasing fee simple home ownership
2. Breaking up the oligopoly of land ownership in Hawaii
3. Controlling lease rent
4. Freeing Lessees from reversion of improvements provisions in surrender clauses
5. Increasing the number of fee simple condominium and cooperative housing units

The interviews and findings of available market data, which are discussed in detail in this study, do not suggest that a mandatory conversion law is the most effective means to obtaining the first four objectives. Some of these findings indicate:

- Condominium purchases have been dominated by non-owner occupants, and not by individuals seeking home ownership. Only 31%, or approximately 16,400 of the leasehold residential condominium units in Hawaii, were owner occupied in 1984-1985.
- The oligopoly of land ownership which characterizes the single-family residential leasehold ownership pattern is not completely analogous to the pattern of land ownership underlying condominium and cooperative housing projects. Therefore breaking up the oligopoly of land ownership in Hawaii is not a public purpose which could support mandatory condominium and cooperative fee conversion.
- 89% or 415 of the landowners of the 754 condominium and cooperative projects in Hawaii own

land under a single condominium or cooperative project.

- There is no market evidence to suggest that the pattern of renegotiated ground rents for condominiums and cooperatives is unreasonable. Since the late 1950s and early 1960s, the growth rates between original and renegotiated ground rents have been consistent with the growth of personal incomes, housing values and consumer prices over similar time periods.

- voluntary fee conversion programs will provide no assurance that leasehold condominium and cooperative apartment owners will ultimately have the opportunity to purchase their leased fee, particularly in view of the severance damages arising from a sale of partial individual interests in the leased fee.

- A significant number of condominium and cooperative housing projects are scheduled for their first lease rental negotiations starting in 1990, and the ability to obtain long term fixed rate financing for leasehold condominium purchases will diminish as lease terms progress. Therefore, it is anticipated that motivations of lessees and lessors may change significantly as these negotiations draw closer, and that support for leased fee conversion relief will increase.

However, if a public purpose is to be identified as the basis for introduction of mandatory conversion legislation, then the fifth objective, increasing the number of fee simple condominium and cooperative housing units, could support the introduction of such legislation. Research indicates that on Oahu, where the majority of residential condominium and cooperative projects are

located, 60% or 518 of the projects and over 70% or 53,898 of the units are leasehold.

So long as the Legislature determines that fee simple ownership of condominium and cooperative housing units is a proper public purpose, mandatory condominium and cooperative fee conversion legislation should be upheld as a proper public use by a federal court following *Hawaii Housing Authority v. Midkiff* or a state court following *Hawaii Housing Authority v. Lyman*.

In order to afford the Legislature an opportunity to explore full range of alternative approaches, it is recommended that Phase II of this study explore two different legislative alternatives:

1. To prepare draft legislation for mandatory condominium and cooperative fee conversions to require conversion of 100% of the leased fee interest under a condominium or cooperative project with a high minimum threshold of applicants. The method would appear to be the most equitable manner to implement a mandatory leased fee conversion process.

2. To prepare limited purpose legislation addressing three issues: rent control, reversionary or surrender clauses in apartment leases and the power of apartment owner associations and cooperative housing corporations to borrow and assess apartment owners to acquire leased fee interests.

The two alternative legislative proposals are recommended to provide the Legislature with a wide range of alternatives for their examination and consideration.

## FINDINGS

### General Issues

In 1987 there were approximately 69,300 units in 754 leasehold condominium, cooperative, planned development and cluster projects in the state of Hawaii. Approximately 51,572 units representing approximately 74.5% of all leasehold units were on land zoned for residential apartment use; 8.3% or approximately 5,725 units were on single-family residential-zoned land, and 15.6% or approximately 10,790 units were on mixed apartment/ commercial, commercial or industrial zoned land.

Approximately 16,400 units representing 31% of the leasehold residential condominium units in Hawaii were owner occupied in 1984-1985. The highest owner occupancy rate is on Oahu, where nearly 16,000 units or about 34% of all residential units were owner occupied. The owner occupancy rate on the neighbor islands is considerably lower, between 2.9% and 11.5%, having a total of approximately 424 units which were owner-occupied.

In a sample of 66 leasehold projects, all the ground leases extend for at least 50 years, and typically for a term of between 55 and 75 years. By 2040, the leases for over 477 projects representing 75% of all existing projects will have expired. Approximately 57 of the 66 projects sampled, about 87%, have known rent periods ranging between 25 and 35 years. Approximately 56 of the leasehold projects sampled have renegotiated rent periods between 25 years and 40 years. The ground rents during the known and renegotiated rent periods are typically fixed in increments of 5, 10 and 15 years. Rent escalations during the

known rent period range typically between 1.0% and 2.9% per year.

The leases for over 50 of the leasehold projects sampled provide for the renegotiated rents to be based on a stated rate of return on the fair market value of the land at the time of rent renegotiation. The rent renegotiation clauses for the remaining projects sampled provide for renegotiation based on fair market rent, a percentage of the rent paid to a master lessor, or rent increases based on the change in the consumer price index. The compound rate of growth between the original and renegotiated ground rents typically ranges between about 1.0% and 5.0% per year. Leases for about 59,200 units in 616 projects, about 90% of the leasehold units in Hawaii, provide for renegotiation of their ground rents between 1990 and 2015.

The median monthly ground rent for the urban Oahu projects sampled was approximately $0.084 per square foot of net apartment area. The monthly median ground rent for suburban Oahu projects sampled was approximately $0.038 per square foot of net apartment area.

As of the date of this study, lessors of 42 leasehold condominium projects (4,870 units) have voluntarily sold leased fee interests to apartment owners. Most of these sales occurred between 1984 and 1987. The participation rate of purchasers for the projects sampled ranges between 2% and 98%. Approximately 3.9% of all leasehold condominium units in Hawaii have been voluntarily converted.

There is no apparent correlation between the owner occupancy rate in a project and the participation rate in the

lease to fee conversion. There is also no significant correlation between the length of the remaining fixed rent period and the lease to fee conversion participation rate.

Leasehold projects in Hawaii occupy approximately 1,920 acres. The largest concentration of leasehold condominium development, with 68% of the total (1,298 acres), is on Oahu. The median and mean lot areas are 38,480 square feet and 110,955 square feet, respectively. 577 projects (78%) are located on sites of three acres or less.

## Policy Issues

The interviews conducted for this study and research into the background and legislative history of the mandatory conversion issue indicate that there are primarily five areas of concern in the leasehold condominium and cooperative housing system. Proponents of mandatory conversion have stated these ares of concern as objectives of mandatory conversion legislation. They are:

1. increasing fee simple home ownership
2. Breaking up the oligopoly of landownership in Hawaii
3. Controlling lease rent
4. Freeing lessees from reversion of improvements provisions in surrender clauses
5. .Increasing the number of fee simple condominium and cooperative housing units

The available market data collected for this study indicates:

- None-owner occupants dominate condominium purchases, not individuals seeking home ownership.

Approximately 16,400 or 31% of the leasehold condominium units in Hawaii were occupied by owners in 1984-1985.

- The average participation rate in voluntary conversions for non-owner occupants (54.8%) is greater than the average participation rate (32.9%) for owner occupants, a statistic which indicates that purchasers may be motivated by considerations other than the desire to own land under one's residence.[1]

- Ownership of land lease for condominium and cooperative projects in Hawaii is dominated by small landowners. Approximately 89% or 415 of these lessors own land under a single condominium or cooperative housing project.

- Condominium and cooperative apartment lessees have not yet experienced the significant lease rent increases experienced by single-family residential lessees. Very few condominium and cooperative lessors and lessees have renegotiated their lease rents as of this date. The few renegotiations that have occurred to date are based on annual compound rates of growth ranging from 1% to 5% of the original ground rents.

- Many lessees say that they were not informed about the reversion of improvements provisions in surrender clauses. They feel that the clause operates unfairly.

The available market data relating to leasehold condominiums and cooperative housing projects does not suggest that a mandatory conversion law is the best means to obtaining the first four objectives mentioned previously. However, if a public purpose is to be identified as the

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[1] Based upon research of motivations of those who did and did not participate in voluntary conversions.

basis for introduction of mandatory conversion legislation, then the fifth objective, increasing the number of fee simple condominium and cooperative housing units, could support the introduction of such legislation.

Alternatives to address the first four objectives listed previously include:

1. Lease rent control legislation
2. Legislation to modify reversion of improvements provisions in surrender clauses

If increasing the number of fee simple condominium and cooperative housing units is the designated public purpose of mandatory conversion legislation, then there should not be any restrictions, such as owner occupancy or first time landownership, on participation in a mandatory conversion program.

Similarly, if the objective is to increase the number of fee simple condominium and cooperative housing units, then all types of residential condominiums and cooperative housing corporations should be included in a mandatory conversion program. The fee underlying the typical high rise condominium and cooperative housing corporation building, would be subject to conversion, as well as the fee underlying cluster developments, planned development housing, and mixed commercial/residential buildings.

If mandatory fee conversion is implemented, HFDC's primary role should be advisory and administrative. Enabling legislation could authorize HFDC to acquire leased fee interests on an interim basis, in order to transfer the leased fee interests to individual lessees; or to

transfer the interests that are not purchased by individual lessees to a condominium association or cooperative corporation.

For condominium projects, a relatively high minimum percentage of lessees should be required to petition HFDC to initiate condemnation of the leased fee. HFDC should also be empowered to condemn 100% of the leased fee interest. It is also recommended that the association be required to purchase the leased fee interest of those lessees who are unwilling to purchase the fee at the time of conversion.

In the absence of a mandatory unanimous fee conversion requirement, the lessees who do not choose to participate in a fee conversion would continue to lease land underlying their units from the landowner, or they could lease from the condominium owners' association, or whoever purchases the leased fee.

A mandatory unanimous conversion would avoid the inequitable situation that would result to a lessor who would be left with a minority undivided remnant leased fee interest in a project or a building that remains beyond the term of the original lease.

For cooperative housing corporations, a lower minimum percentage (51%) of apartment owners should be required to petition the HFDC to initiate condemnation of the leased fee, but the corporation must purchase the entire leased fee. Since a cooperative has a single lease from the landowner, and the cooperative is organized as a

corporation, a simple majority can and should be able to bind all apartment owners.[2]

## Finance and Value Issues

Partial lease to fee conversions adversely affect lessors in the following ways:

- Higher administrative costs
- Loss of control at reversion
- Disproportionately lower value of the remaining partial interest

Alternatives are available to finance apartments with fixed lease terms of less than ten years. The sales prices of such units do not yet appear to be adversely impacted by an inability to obtain long term financing.

The combined leasehold and leased fee prices of sampled condominium units averaged 13% higher than their respective leasehold prices. Similarly, the price differential between leasehold and fee simple sale prices in the same projects averaged about 12%.

Under the 1986 Tax Reform Act, it would be extremely difficult, though technically possible, for HFDC to issue tax exempt bonds to finance the acquisition of leased fee interests by lessees. To be tax exempt, such issues would have to meet the exemptions for qualified mortgage bonds or qualified veterans' mortgage revenue bonds.

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[2] Under general principles of corporate law, majority vote of the stockholders is sufficient to bind all stockholders unless the articles of incorporation on by-laws otherwise provide.

Both exemptions would necessitate very restrictive qualifications for borrowers, as well as highly scrutinized administration of the loan program.

Additionally, even if the bonds were qualified private activity bonds, they would be subject to the state's overall volume cap on issuance of qualified private activity bonds for each calendar year. As an alternative HFDC could consider the issuance of taxable bonds to finance acquisition of leased fee interests.

Savings and loans and banks could represent significant originators of financing for leased fee purchases. However, due to their emphasis on residential mortgage lending, where individual loan requirements are small, financing could be expected to be more readily available from savings and loan institutions than from banks. Savings and loans and banks could also be expected to develop special packages and/or terms for such loans if the volume of demand merited it.

On the other hand, agreements of sale, which were significant residential financing vehicles in recent years, could be expected to be rare due to the changes in federal tax law in 1986. In the future, agreements of sale are likely to be offered only where the transaction may be considered tax-exempt.

In addition, due to the relatively low amount of the typical leased fee purchase compared to residential unit purchase requirements, other sources of financing and capital that have supported residential home loans could also be active in the leased fee purchase market. These other sources of financing could include:

- Employee profit sharing plans
- 401K and similar employee benefit plans
- Credit unions
- Mortgage brokers
- Industrial loan or finance companies
- Purchase money mortgages
- Loans from friends or family members
- HFDC financing with taxable bonds, subject to Legislative approval.

Potential economies of scale associated with loans made to groups of buyers within a single project are likely to be largely unrealizable due to the need to evaluate the creditworthiness of individual buyers. Even if a homeowners' association could incorporate, with the corporation's creditworthiness being evaluated on the basis of the prior history of lease payments made to the landowner, the security of such a loan would still depend on the creditworthiness of the individual unit owners.

Regarding financing options for elderly condominium unit owners, there are currently no special programs in Hawaii for owners who cannot afford lease rent increases or to purchase the leased fee interest. Possibilities for assistance include lease rent controls for the elderly, a lease rent deferral program, government subsidized housing payments, or family financial assistance.

## Legal Issues

Regarding the constitutionality of mandatory lease to fee conversion legislation for condominiums and cooperatives,

as long as a legitimate public purpose can be asserted (such as the need for widespread fee simple ownership in order to wisely conserve, preserve, use, and manage land in the State in a way which promotes a decent and healthful standard of life) and a rational basis can be established for using eminent domain to advance this legitimate public purpose, then legislation to permit such mandatory conversions would not violate the "public use" clauses of the Fifth Amendment to the U.S. Constitution, or Article I, Section 20 of the Hawaii Constitution.

A statute analogous to the single-family residential statute relating to surrender clauses applicable to condominium and cooperative leases should recognize that condominium and cooperative leases are popular forms of residential home ownership which involve large scale residential developments. The statute should also recognize that a lessor's surrender clause could require lessees to pay for an expensive demolition of a building, at a time when lessees may be unable to afford such an expense (when lessees have to locate replacement housing).

A new law should afford a lessee an option to remove the improvement for his own use and benefit, or require the lessor to pay for the improvement at the end of the lease term. This would eliminate the problem of a lessor getting a "windfall", which is the project paid for by the lessees, or attempting to force the lessees to bear the costs of clearing the lessor's property for redevelopment.

Any proposed new statute should be given retroactive effect for cooperative and condominium leases made prior to the law's enactment. The statute must expressly

state that it was intended by the Legislature to have retroactive effect.

Regarding the refinancing and/or resale of units, commercial multi-family leasehold lending guidelines affect the ability to refinance or resell the units in two ways. These guidelines are as follows:

1. At time of loan origination, there must be at least ten (10) years remaining on the fixed rental period of the lease agreement.

2. The total term of the leasehold interest must expire in no less than five (5) years after the end of the loan term.

The first criteria raises some difficulties in obtaining long-term conventional financing for condominium units, but lending institutions do make loans for units with less than the ten (10) years of fixed term remaining, so long as there is a recorded amendment to the apartment lease agreement which fixes the lease rent in the subsequent period. However, since the lessee and lessor would have to renegotiate their rental terms anyway, this guideline tends primarily to encourage unit owners to do so earlier.

Of potentially greater concern is the lending requirement that the total lease term expire no less than five years following the end of the loan term. Although state law (see HRS Section 407-85) requires only a two-year buffer, lenders, guided by the requirements of the secondary mortgage market as well as their own need for loan collateral, tend to be slightly more conservative than required by law, and generally require five years. This stipulation is not a major issue currently, since the majority of leasehold multi-family units have more than 43 years remaining on their lease terms.

However, if there were no further lease to fee conversions, by 1990, 31% of the existing leasehold projects, or 21% of the existing leasehold units could become ineligible for 30-year commercial financing. Approximately 2% of existing leasehold projects, representing only 1% of existing leasehold units, would also then be ineligible for 15-year commercial financing.

Means of avoiding this result could include the following:

- To obtain loans with shorter loan terms from conventional lending sources, such as 3 to 10 year ARMs (Adjustable Rate Morgages) or personal unsecured loans.
- To obtain short term owner financing arrangements such as Agreements of Sale (in instances where the transaction would be considered tax-exempt) or Purchase Money Mortgages.
- To obtain a renegotiation of lease terms or purchase of the leased fee interest by unit owners. These steps would be necessary in any case to protect the value of the unit.

Tax Issues

Regarding the impact of tax incentive for the landowner in a mandatory conversion program, the most significant changes of the 1986 Tax Reform Act (TRA) concern taxes paid on capital gains, new limitations concerning passive activity losses, and changes in the treatment of installment sales accounting. These changes are expected to affect both federal and state taxes, since the State of Hawaii tax law is conforming to most of the new federal standards on most issues.

1. Capital gains

   Formerly, the maximum effective tax rate paid on capital gains was 20%, which resulted from 60% of gains being tax-exempt, and the remaining 40% being subject to the top marginal tax rate of 50%. Following the TRA, however, the special tax treatment of capital gains was eliminated, and long term gains are now taxed like ordinary income. Since the maximum effective rate is now 33% for individuals (28% plus a 5% "surcharge" in certain income brackets), and 34% for corporations, the tax rate applied to capital gains for most investors will be significantly greater than in the past.

   However, Section 1033 of the Internal Revenue Code (the "Code") still permits the deferral of taxes on capital gains resulting from the sale of real property in an involuntary conversion. This provision permits the deferral of taxes on that portion of the gain that is reinvested in property of "like kind," and has been held in letter rulings by the IRS to apply to gains from properties converted under threat of condemnation, as well as in cases where a condemnation actually took place. Together with the higher effective rates on capital gains, these provisions should have the effect of encouraging reinvestment of gains in properties of "like kind."

   Although the TRA eliminated the special tax treatment of capital gains, it retained the mechanism for distinguishing such revenues from other income. Thus, the TRA continues to recognize the special nature of capital gains, and further changes to their tax treatment could be more easily achieved.

2. Passive activity losses

   The TRA classified a real estate investor's gross income into two categories: passive activity income

(including most realty income and loss) and all other income. A passive activity is defined as the conduct of any trade or business in which the taxpayer does not materially participate. The new law prevents much of the sheltering of earned and portfolio income that was previously possible with losses from passive activities such as real estate investments, and passive activity losses are generally deductible only against passive activity gains. However, the TRA permits a taxpayer to offset up to $25,000 of non-passive income with passive activity losses such as from rental real estate activities where the taxpayer actively participates. (Active participation requires only that the taxpayer make a significant contribution to the management and operation of a real estate rental activity, and is a less stringent requirement than material participation.) The amount of the other income or tax thereon which may be offset is reduced at adjusted gross incomes between $100,000 and $150,000, and is completely phased out at adjusted gross income levels above $150,000.

Thus, landowners forced to sell their leased fee interests could unexpectedly lose a means of generating passive losses, resulting in passive income gains being not fully offset by passive activity losses, and thus a higher than expected tax liability. Therefore, the TRA could be expected to encourage the reinvestment of income from the sale of a leased fee interest in other activities that could generate passive losses.

3. Installment sales accounting

The TRA significantly revised the special treatment of taxes on profits from capital gains where payments are received in installments. Previously, many of the tax consequences could be deferred to future tax periods, but under the new law, eligibility for such deferral appears to have been significantly curtailed.

Thus, even where payment is received in installments, as in an Agreement of Sale on a leased fee interest, many sellers would be taxed on the full amount of the exchange at the time of the sales agreement. This could be expected to drastically reduce the attractiveness of owner financing in the form of Agreements of Sale, except for those sellers for whom the sales transaction could be classified as tax exempt.

* * *

Exhibit D

Mixed Use Condominiums

| Condominium | Location | Number of Units | | |
|---|---|---|---|---|
| | | Residential | Commercial | Total |
| Oahu | | | | |
| Canterbury Place | Waikiki | 146 | 5 | 151 |
| Century Center | Kapiolani | 136 | 159 | 295 |
| Executive Centre | Downtown | 205 | 359 | 564 |
| [illegible] Hale | Kaneohe | 134 | 1 | 135 |
| [illegible] Square | Downtown | 358 | 12 | 370 |
| [illegible]an Monarch | Waikiki | 434 | 6 | 440 |
| [illegible]al Hawaii Resort | Waikiki | 270 | 16 | 286 |
| [illegible] On The Park | Waikiki | 238 | 9 | 247 |
| [illegible]ani Court Plaza | University | 341 | 6 | 347 |
| Island Colony | Waikiki | 740 | 5 | 745 |
| Kukui Plaza | Downtown | 908 | 46 | 954 |
| Liliuokalani Gardens | Waikiki | 382 | 3 | 385 |
| Marco Polo | University | 549 | 23 | 572 |
| Pacific Monarch | Waikiki | 216 | 2 | 218 |
| Rainbow Terrace | University | 31 | 2 | 33 |
| Royal Aloha | Waikiki | 141 | 2 | 143 |
| Seashore, The | Waikiki | 54 | 1 | 55 |
| Sherry Waikiki I | Waikiki | 48 | 1 | 49 |
| Sherry Waikiki II | Waikiki | 53 | 1 | 54 |
| University Plaza | University | 24 | 27 | 51 |
| Villa on Eaton Square | Waikiki | 425 | 60 | 485 |
| Village Maluhia, The | Makiki | 160 | 1 | 161 |
| Subtotal – Oahu | | 5,993 | 747 | 6,740 |
| Maui | | | | |
| Hale Kaanapali | Kaanapali | 232 | 30 | 262 |
| Kahana Villa | Kahana | 98 | 8 | 106 |
| Milowai-Maalaea | Maalaea | 36 | 7 | 43 |
| Sugar Beach Resort | Maalaea | 215 | 3 | 218 |
| Subtotal – Maui | | 581 | 48 | 629 |
| Hawaii | | | | |
| Honalo Plaza | Honalo | 18 | 12 | 30 |
| Kauai | | | | |
| Islander On The Beach | Kapaa | 200 | 9 | 209 |
| Pali Ke Kua II | Princeville | 28 | 1 | 29 |
| Subtotal – Kauai | | 228 | 10 | 238 |
| Total | | 6,820 | 817 | 7,637 |

Source: Hawaii TMK Service, *Condominium Guides*, 1980-1985; Real Estate Data, Inc., *Real Estate Atlas of the State of Hawaii*, 1986; and John Child & Company, Inc.

* * *

3. *Who owns condominiums and apartments in cooperative housing projects, transients or investors, and the age ranges of owners or stockholders?*

Based on the number of homeowner's exemption claims for real property taxes, approximately 31% of the leasehold residential condominium units (16,415 units) in the State of Hawaii in 1984-1985 were occupied by owners, as shown in Exhibit F.

The owner occupancy rate is highest on Oahu, at approximately 34% or nearly 16,000 of leasehold units. The owner occupancy rate on the neighbor islands ranges between 2.9% and 11.5%, substantially below the rate on Oahu. Neighbor island units are more likely to be located in resort areas and are often used for second home occupancy and resort rentals.

There were no owner occupants for condominium units classified as "Hotel" by their respective County Tax Offices.[1] Based on data for 1984, there were 5,218 leasehold condominium units in the State of Hawaii which were classified as being used for "Hotel" or short-term rental use, none of which were occupied by home owners. The distribution of these leasehold units by County is shown in Exhibit G.

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[1] Based on those leasehold condominiums with a 700 Pitt Code classification which denotes properties used for hotel purposes; actual uses may differ.

Exhibit F

## Leasehold Condominium Units with Homeowner's Exemptions 1984-1985

| | Leasehold residential condominium units [1] | Home Exemptions | |
|---|---|---|---|
| | | Total | Percentage of condominium units |
| Oahu | 46,997 | 15,991 | 34.0% |
| Maui | 2,344 | 269 | 11.5 |
| Hawaii | 1,775 | 113 | 6.4 |
| Kauai | 1,431 | 42 | 2.9 |
| Total | 52,547 | 16,415 | 31.2 |

[1] Includes all leasehold condominium units with a Pitt Code of 100 (improved residential) or 200 (apartment); excludes 6,848 leasehold condominiums with a Pitt Code of 700 (hotel) or 300 (commercial) for which there were no owners claiming homeowner's exemptions.

Source: Real Property Tax Assessment tapes, 1984-1985.

Exhibit G

Leasehold Condominiums With a
Pitt Code of 700 (Hotel) Classification
1984-1985

| | Units |
|---|---|
| Oahu | 1,266 |
| Maui | 3,742 |
| Hawaii | 0 |
| Kauai | 210 |
| Total | 5,218 |

Source: Real Property Tax Assessments tapes, 1984-1985.

In a survey prepared by SMS Research & Marketing Services, Inc. ("SMS")[2], nearly 52% of the respondents indicated they were owner-occupants at the time of the survey; however, only 38% indicated they wanted to make their present apartment their permanent home. As discussed in the SMS study, the survey sample appeared to over-represent individual residential owners and under-represent commercially held condominium units, and, therefore, overstated the percentage of all condominium units in home ownership.

Other demographic data about leasehold condominium owners, based on the SMS study, are summarized as follows:

- Nearly all owners (88%) were over 35 years of age; 44% were over 55 years.

- Leasehold condominium owners tended to include more Caucasians and Chinese than the percentage these groups comprise in the general population, and considerably fewer Filipinos and Hawaiians.

- Household incomes of leasehold condominium owners of leasehold condominium owners were relatively high with only 23% of the owners having incomes below the median household income for the State of Hawaii, estimated at $30,000.

- The reported net worth of leasehold condominium owners is relatively high; fewer than 27% reported net worth below $100,000.

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[2] SMS Research & Marketing Services, Inc., *Leasehold Condominium Owners: A Study To Inform Legislative Action*, December 1986.

4. *What are the terms of lease rent renegotiations and when will these renegotiations come up?*

Terms of lease rent renegotiations vary from project to project. The typical lease characteristics are described in the following subsections in terms of the:

- Length of the total, fixed and renegotiated rent periods.
- Structure of the fixed and renegotiated rent periods.
- Trends in increases in monthly lease rent during the first known rent period.
- Rent escalations during the fixed rental period.
- Basis of rent renegotiations.
- Commencement of rent renegotiations.[3]

*Length of the Total, Known and Renegotiated Rent Periods*
For this study, 66 projects were randomly selected from the 754 residential leasehold condominium projects in the State of Hawaii to study the structure of the typical unit leases. The leasehold projects selected are shown in Exhibit H. The 66 projects comprise about 9% of the total of all leasehold projects and represent a cross section of all leasehold projects.

All selected ground leases extend for a period of at least 50 years and typically extend for a term of between 55 and 75 years, as shown in Exhibit I.

By 2040, the leases for over 75% of all the existing projects (532 projects) and 60% of all the existing

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[3] Based on a review of the initial renegotiation dates for all leasehold condominium, cooperative, planned development, and cluster projects.

units (40,056 units) will have expired, as shown in Exhibit J.

The fixed rent period of a lease is that period during which the amount of rent is stated in the lease, although not necessarily held constant. Approximately 73% of all the projects have fixed rent periods between 25 and 34 years, as shown in Exhibit K.

The renegotiated rent period is that period for which time the ground rent is renegotiated under the method stated in the lease. Approximately 70.9% of the projects have renegotiated rent periods between 25 years and 39 years, as shown in Exhibit K.

Exhibit H

Selected Leasehold Developments

| Condominium | Land area ($) | Year built | No. of units | Salable area apartment ($) |
|---|---|---|---|---|
| Condominiums | | | | |
| Ala Wai Plaza | 164,683 | 1971 | 349 | 396,188 |
| Chateau Waikiki | 70,605 | 1975 | 459 | 257,828 |
| College Gardens, I-IV | 313,371 | 1984 | 120 | 104,204 |
| Crescent Park | 20,000 | 1970 | 62 | 56,186 |
| Eden At Haiku Woods, B | 93,598 | 1976 | 13 | 18,055 |
| Harbor Shores | 39,447 | 1966 | 42 | 28,782 |
| Holiday Village | 49,719 | 1967 | 238 | 75,066 |
| Ilima Apartments | 18,541 | 1975 | 31 | 18,344 |
| Kewalo, 1412 | 7,858 | 1980 | 19 | 12,636 |
| Kinau Lanais | 18,750 | 1974 | 183 | 93,600 |
| Kinau Villa | 17,100 | 1975 | 76 | 48,560 |
| Lakeview Plaza | 22,800 | 1974 | 40 | 24,240 |
| Lehua Nani | 22,500 | 1975 | 49 | 33,306 |
| Liholiho Regency | 7,605 | 1980 | 18 | 9,810 |
| Lusitana, 1882/1888 | 18,215 | 1980 | 21 | 10,464 |
| Lynwyd | 34,171 | 1973 | 44 | 32,596 |
| Maunaihi Terrace | 32,990 | 1974 | 75 | 54,090 |
| Mokuleia Hale | 13,414 | 1974 | 18 | 9,162 |
| Mott-Smith Laniloa | 113,043 | 1976 | 428 | 329,963 |
| Mount Terrace | 161,128 | 1974 | 126 | 203,730 |
| Nahoa Apartments | 431,244 | 1975 | 231 | 176,715 |
| Nahua, 444 | 23,426 | 1976 | 192 | 103,928 |
| Nuuanu Towers | 51,813 | 1979 | 40 | 29,000 |
| Pacific Gardens | 57,218 | 1966 | 66 | 46,332 |
| Palo Alto, The | 16,884 | 1969 | 29 | 29,820 |
| Pan Pacific | 20,568 | 1969 | 24 | 16,650 |
| Park Surf | 6,420 | 1974 | 10 | 5,413 |
| Pearl Manor Apartments | 48,760 | 1966 | 40 | 30,920 |
| Plaza Hawaii Kai | 125,570 | 1974 | 146 | 165,830 |
| Poinciana Manor | 220,764 | 1975 | 180 | 27,410 |
| Puana Malu | 20,828 | 1975 | 24 | 19,644 |
| Ridgeway, Unit D | 101,539 | 1971 | 94 | 111,438 |
| Sierra Gardens | 14,613 | 1982 | 24 | 11,568 |
| Sky Tower | 34,566 | 1967 | 89 | 74,820 |
| Tradewinds Plaza | 10,000 | 1979 | 80 | 28,490 |
| Tropic Gardens | 486,294 | 1966 | 216 | 222,120 |
| University Court | 17,120 | 1980 | 42 | 19,874 |
| Victoria Mansion | 25,000 | 1966 | 57 | 39,252 |
| Victoria Plaza | 35,000 | 1968 | 72 | 62,140 |
| Waiau Gardens Kai A | 437,616 | 1973 | 107 | 123,336 |
| Waikiki Cove | 4,414 | 1979 | 23 | 12,040 |
| Wilder at Piikoi | 54,657 | 1974 | 166 | 100,786 |
| Wilder Regent | 53,930 | 1972 | 40 | 33,400 |
| Wilola Apartments | 16,115 | 1972 | 28 | 19,836 |
| Windward Harbour | 160,673 | 1980 | 95 | 117,515 |
| Kaanapali Alii | 348,959 | 1982 | 264 | 392,362 |
| Kihei Bay Surf | 123,710 | 1970 | 118 | 52,510 |
| Kuleana II | 37,462 | 1973 | 99 | 14,074 |
| Papakea I | 535,047 | 1975 | 216 | 144,957 |
| Whaler On K. Beach I | 290,545 | 1975 | 180 | 153,936 |

| Condominium | Land area ($) | Year built | No. of units | Salable area apartment ($) |
|---|---|---|---|---|
| Keauhou Palena | 212,529 | 1978 | 56 | 49,168 |
| Kona Makai | 175,786 | 1979 | 42 | 35,670 |
| Poipu Shores | 98,342 | 1977 | 39 | 38,169 |
| Wailuna II | 142,833 | 1983 | 24 | 27,726 |
| Cluster | | | | |
| Kalani Iki, I | 880,827 | 1974 | 95 | 113,299 |
| Commercial | | | | |
| Aiea-Medical Building | 52,623 | 1978 | 47 | 43,012 |
| Century Square | 31,897 | 1982 | 366 | 188,818 |
| Halawa Industrial Park | 47,871 | 1982 | 14 | 22,448 |
| Cooperatives | | | | |
| Alii | 5,130 | 1959 | 16 | 8,676 |
| Canal Classic | 11,610 | 1960 | 6 | 8,820 |
| Diamond Alii | 31,890 | 1961 | 54 | 30,798 |
| Diamond Head Terrace | 15,002 | 1960 | 25 | |
| Hale Laau I | 5,805 | 1959 | 8 | 4,000 |
| Nanea Apts. | 24,601 | 1959 | 48 | 22,272 |
| Oahuan Tower | 10,000 | 1958 | 57 | 28,500 |
| Planned Unit Development | | | | |
| Puu Alii V | 129,896 | 1979 | 34 | 33,154 |

Source: Hawaii TMK Service, *Condiminium Guides*, 1980-1985; and John Child & Company, Inc.

Exhibit I

Distribution of Selected Leasehold Developments by the Length of the Total Lease Term
(Years)

| Length of total lease term | Percent [1] |
|---|---|
| 50 | 6% |
| 55 | 45 |
| 60 | 17 |
| 65 | 11 |
| 70 | 6 |
| 75 | 14 |
| 80 or more | 1 |
| Total | 100% |

[1] Based on 66 leasehold condominium, cooperative, planned unit development, and cluster projects, shown in Exhibit H.

Source: Hawaii TMK Service, *Condominium Guides*, 1980-1985; and John Child & Company, Inc.

Exhibit J

## Distribution of Leasehold Condominiums by Year of Lease Termination[1]

| Year | Projects | | | Units | | |
|---|---|---|---|---|---|---|
| | | Cumulative | | | Cumulative | |
| | No. | Total | Percent | No. | Total | Percent |
| 1990-1999 | 5 | 5 | 0.7% | 98 | 98 | 0.1% |
| 2000-2009 | 17 | 22 | 3.1 | 477 | 575 | 0.9 |
| 2010-2019 | 82 | 104 | 14.8 | 3,252 | 3,827 | 5.8 |
| 2020-2029 | 149 | 253 | 35.9 | 10,219 | 14,046 | 21.3 |
| 2030-2039 | 279 | 532 | 75.6 | 26,010 | 40,056 | 60.7 |
| 2040-2049 | 125 | 657 | 93.3 | 16,063 | 56,119 | 85.0 |
| 2050-2059 | 36 | 693 | 98.4 | 8,365 | 64,484 | 97.7 |
| 2060-2069 | 7 | 700 | 99.4 | 423 | 64,907 | 98.4 |
| 2070-2079 | 4 | 704 | 100.0 | 1,083 | 65,990 | 100.0 |

[1] Includes all residential, mixed-use, commercial and industrial projects except for 3,264 units in 50 projects for which lease information was not available.

Source: Hawaii TMK Service, *Condominium Guides*, 1980-1985: Real Estate Data, Inc., *Real Estate Atlas of the State of Hawaii*, 1986; and John Child & Company, Inc.

Exhibit K

Distribution of Projects by Lengths
of the Fixed and Renegotiated Lease Terms[1]

| Total length in years | Fixed Term | | Renegotiated Term | |
|---|---|---|---|---|
| | Projects | Percent | Projects | Percent |
| Less than 20 | 56 | 7.9% | 19 | 2.7% |
| 20 to 24 | 76 | 10.7 | 48 | 6.8 |
| 25 to 29 | 374 | 52.9 | 233 | 33.0 |
| 30 to 34 | 144 | 20.4 | 161 | 22.8 |
| 35 to 39 | 28 | 4.0 | 107 | 15.1 |
| 40 to 44 | 12 | 1.7 | 62 | 8.8 |
| 45 and over | 17 | 2.4 | 77 | 10.8 |
| Total | 707 | 100.0% | 707 | 100.0 |

[1] Includes all residential, mixed-use, commercial and industrial projects except for 47 projects for which lease information was not available.

Source: Hawaii TMK Service, *Condominium Guides*, 1980-1985; and John Child & Company, Inc.

*Structure of the Fixed and Renegotiated Rent Periods*
The ground rents during the fixed and renegotiated rent periods are typically determined in increments of 5, 10 or 15 years, depending on the total length of the respective fixed and renegotiated rent periods, as shown in Exhibit L.

*Trends in Lease Rent During the First Fixed Rent Period*
Monthly lease rents increase over time, paralleling the general rise in land values. Median monthly lease rents during the initial fixed rental period for those projects sampled in urban Oahu have increased from about $0.03 per square foot of net apartment area during the 1960's to over $0.08 per square foot of net apartment area during the first half of the 1980's, as shown in Exhibit M. Similar patterns were shown for those projects sampled in suburban Oahu. However, the pattern is less apparent for those projects on the neighbor islands because fewer projects were in the sample.

*Rent Escalations During the Fixed Rent Period*
The lease rents during the fixed rent periods are typically fixed in increments of 5, 10 and 15 years. Rent escalations are estimated as the compound rate of increase between the fixed rents during the fixed rent period and are typically between 1.0% and 2.9% per year, with a mean and median between 2.5% and 2.8%, as shown in Exhibit N. Based on these average rates, rents could be expected to increase between about 25% and 30% over a 10-year period.

Exhibit L

Distribution of Projects by the Structure of the Fixed and Renegotiated Lease Rent Periods [1]

| Total length in years | Fixed | Renegotiated |
|---|---|---|
| 25 Years: | | |
| 5/10/10 | 18% | 70% |
| 10/15 | 18 | – |
| 15/10 | 18 | 10 |
| 25 | 27 | 15 |
| Other | 19 | 5 |
| Total | 100% | 100% |
| 30 Years: | | |
| 10/10/10 | 37% | 100% |
| 15/15 | 37 | – |
| Other | 26 | – |
| Total | 100% | 100% |
| 35 Years: | | |
| 10/10/10/5 | – | 38% |
| 10/10/15 | 38% | 50 |
| Other | 62 | 12 |
| Total | 100% | 100% |
| 40 Years: | | |
| 10/10/10/10 | 67% | 57% |
| Other | 33 | 43 |
| Total | 100% | 100% |

[1] Based on a sample of 66 condominium, cooperative, planned unit development, and cluster projects.

Source: Hawaii TMK Service, *Condominium Guides*, 1980-1985; and John Child & Company, Inc.

* * *

5. *What are the lease rents currently being paid?*

Factors which influence lease rent payments include:

- Location
- Number of units (density)
- Prepaid rent
- Other considerations

The review of current ground rents does not consider the variations in lease rental payments resulting from these and other factors.

Monthly ground rents for those urban Oahu projects which were constructed since 1980 and included in the sample ranged between about $0.08 and $0.11 per square foot of net apartment area. The median was about $0.084, as previously shown in Exhibit M.

Similar monthly ground rents for those projects in suburban Oahu range between about $0.02 and $0.08 per square foot of net apartment area, with a median of about $0.038.

* * *

3. *Controlling Lease Rent*

Eliminating unreasonable lease rent increases through lease rent control is also frequently stated as an objective of mandatory conversion legislation. However the market data provided in the preceding section does not suggest any pattern that renegotiated ground rents are unreasonable.

Since the late 1950s and early 1960s, the growth rates between original and renegotiated ground rents have been consistent with the growth of personal incomes, housing values and consumer prices over similar time

periods, as shown in Exhibit Z. If renegotiated ground rents become unreasonable, a rent control law such as Real Property Leases, HRS Statutes Chapter 519, should be considered to address the lease rent problem at hand, rather than a mandatory conversion law which may achieve a result other than stabilization of ground rents. Additional legal analysis to follow.

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Supreme Court, U.S.
FILED
AUG 13 1998
OFFICE OF THE CLERK

No. 98-78

IN THE
# Supreme Court of the United States
OCTOBER TERM, 1998

CITY AND COUNTY OF HONOLULU,
*Cross-Petitioners,*

v.

SMALL LANDOWNERS OF OAHU, and RICHARD S. H. WONG, OSWALD K. STENDER, MARION M. L. LINDSEY, GERARD A. JERVIS, and HENRY H. PETERS, in their capacities as Trustees of the Kamehameha Schools Bernice Pauahi Bishop Estate,
*Cross-Respondents.*

**On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit**

## CROSS-RESPONDENTS' BRIEF IN OPPOSITION TO THE CONDITIONAL CROSS-PETITION

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August 13, 1998

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

## QUESTION PRESENTED

Whether the court of appeals and district court correctly applied an admittedly proper legal standard to the facts of this case to conclude that a local rent-control ordinance governing ground leases for condominium owners violated the Takings Clause of the Fifth Amendment because it did not substantially advance its stated goal of ensuring affordable condominium housing.

## STATEMENT REQUIRED BY RULE 29.6

Pursuant to Rule 29.6 of the Rules of this Court, cross-respondents state the following:

Cross-respondent Small Landowners of Oahu is a Hawaii non-profit corporation that has no corporate parents or non-wholly-owned subsidiaries. Cross-respondents Wong, Stender, Lindsey, Jervis and Peters are the Trustees of the Kamehameha Schools Bernice Pauahi Bishop Estate, a charitable trust that erects and maintains schools for the education of children, giving preference to indigents and orphans who are Native Hawaiians. Kamehameha Schools Bernice Pauahi Bishop Estate has no corporate parents. Its non-wholly-owned subsidiaries are as follows:

Montrose Land Acquisition, L.P.
Meridian Associates, L.P.
Southern Nevada Income Properties, L.P.
Sino Finance Group, L.L.C.
Unison Pacific Investment (U.S.), Ltd.
Montrose Erwin Square Investors, L.P.
Erwin Square, L.P.
Greensview Associates, L.P. I and II
CONAM Harbor Point Associates, L.P.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1998

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No. 98-78

---

CITY AND COUNTY OF HONOLULU,
*Cross-Petitioners,*

v.

SMALL LANDOWNERS OF OAHU, and RICHARD S. H. WONG, OSWALD K. STENDER, MARION M. L. LINDSEY, GERARD A. JERVIS, and HENRY H. PETERS, in their capacities as Trustees of the Kamehameha Schools Bernice Pauahi Bishop Estate,
*Cross-Respondents.*

---

**On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit**

---

## CROSS-RESPONDENTS' BRIEF IN OPPOSITION TO THE CONDITIONAL CROSS-PETITION

---

In their conditional cross-petition ("Cond. Pet."), the City and County of Honolulu (the "City") concede that the "Court of Appeals correctly identified the standard applicable to [cross-respondents'] challenge to Ordinance 91-96." Cond. Pet. 5. It is therefore not surprising that the City fails to identify any conflict between the court of appeals' decision and any decision of this Court or of any other court. Instead, the City argues that the court of appeals misapplied the admittedly correct legal stand-

ard to the facts when it held that City Ordinance No. 91-96 constituted an uncompensated taking that violated the Fifth and Fourteenth Amendments. Contrary to the City's fact-intensive arguments, the Court of Appeals correctly concluded that Ordinance No. 91-96 failed to substantially advance its stated goal of ensuring the affordability of condominium housing because reductions in ground-lease rents paid by condominium owners would be completely offset by increased purchase costs for ownership of condominiums with below-market, rent-controlled ground leases. In any event, the lower courts' unremarkable application of an admittedly proper legal standard to the facts of this case raises no legal issues worthy of this Court's attention. The City's inherently factbound conditional cross-petition should be denied.

## COUNTERSTATEMENT OF THE CASE

1. The City's conditional cross-petition is the latest chapter in the City's effort to resurrect an earlier rent control ordinance that was struck down by a federal district court as a violation of the Takings Clause of the Fifth Amendment. See *Richardson* v. *City & County of Honolulu*, 759 F. Supp. 1477 (D. Haw. 1991) (Ezra, J.) ("*Richardson I*"). The City did not appeal that decision but instead sought to avoid it by enacting Ordinance No. 91-96, the equally flawed rent-control scheme at issue in this case. See Cond. Pet. App. A1-A30 (setting forth the text of Ordinance No. 91-96). Both the district court, Pet. App. 65a, and the court of appeals, Pet. App. 31a, held that Ordinance No. 91-96 also violated the Takings Clause of the Fifth Amendment. Since those decisions, members of the City Council have introduced yet another rent-control bill designed to remedy the acknowledged "constitutional infirmities" that plague its last two efforts. Opp. App. 2a.

2. When it enacted Ordinance No. 91-96, the City Council stated in its "Findings and Purpose" section that

this rent-control ordinance was designed to "serv[e] the public purpose of maintaining the affordability of housing for owner-occupants." Cond. Pet. App. A6. Specifically, the City Council found that a majority of the owner-occupants of condominium units on Honolulu pay rent to the owners of the land underneath their condominium units pursuant to long-term ground leases. *Id.* at A2. Many of these long-term ground leases contain provisions requiring renegotiation of the ground-lease rent after "initial fixed rent periods" of "25 to 30 years," *id.* at A3, based on the "fee simple value of the land on which the leasehold residential apartments are situated," *id.* Not surprisingly, because the "initial fixed rent[s]" were based on "prevailing market lease rents" prevalent 25 to 30 years ago, *id.* at A2, renegotiations have brought ground-lease rents that were below fair market value for many years more in line with current market conditions.

Ordinance No. 91-96 affected ground-leases in at least two significant respects. *First*, Section 1.4 of Ordinance No. 91-96 limited when and how often renegotiation of a ground-lease rent could occur by providing that the first ground-lease renegotiation "shall not be scheduled before the fifteenth year following the initial date of the lease" and that subsequent renegotiations "shall occur no more frequently than every ten years from and after the rent renegotiation date." Cond. Pet. App. A11. *Second*, Section 1.5 of Ordinance No. 91-96 created a ceiling on the maximum amount of renegotiated rent, which was determined by multiplying the "initial lease rent" by a "rent factor." Cond. Pet. App. A13.[1]

---

[1] Under § 1.1 of Ordinance No. 91-96, the "Initial lease rent" was the greater of (1) the "beginning lease rent" at the effective date of the lease or (2) "the reasonable market value rent prevailing at the effective date of the apartment lease." Cond. Pet. App. A8. Under § 1.5, the "rent factor" was the "average consumer price index ('CPI') for the six-month period in which the rent renegotiation occurs divided" by the CPI at the time of the effective date of the initial lease rent. *Id.* at A13.

Ordinance No. 91-96 was also unusual in that it contained a provision that contemplated "the conveyance of condominiums subject to renegotiated leases on the underlying land." See Pet. App. 26a. Section 1.10 of Ordinance No. 91-96 stated that whenever an owner-occupant transferred his leasehold interest to another person who intended to be an owner-occupant, the below-market renegotiated rent also would apply to the new owner-occupant. Cond. Pet. App. A26. As a result, Section 1.10 of Ordinance No. 91-96 allowed a condominium owner to transfer his right to below-market rentals to a new owner and thereby to command a premium for that right in the form of a higher condominium price. See Pet. App. 62a.

3. Cross-respondents Wong, Stender, Lindsey, Jervis and Peters, as trustees of the Kamehameha Schools Bernice Pauahi Bishop Estate ("Kamehameha Schools") brought suit challenging the constitutionality of Ordinance No. 91-96. Similarly, cross-respondent Small Landowners of Oahu ("SLO") brought a parallel suit challenging the constitutionality of Ordinance No. 91-96. Pet. App. 5a-6a.[2] In its suit, Kamehameha Schools filed a motion for summary judgment seeking to invalidate Ordinance No. 91-96 as an unconstitutional regulatory taking under the Fifth and Fourteenth Amendments.

a. The district court granted summary judgment to Kamehameha Schools, holding that Ordinance No. 91-96 constituted an uncompensated regulatory taking that violated the Fifth and Fourteenth Amendments. Pet. App. 61a, 65a. *First*, relying on this Court's decisions in *Pen-*

---

[2] SLO's motion to consolidate its lawsuit with the action initiated by Kamehameha Schools was denied. Pet. App. 6a. Thereafter, once Ordinance No. 91-96 was struck down as unconstitutional by Judge Ezra in the Kamehameha Schools' action, SLO and the City stipulated to dismiss SLO's claim regarding the constitutionality of Ordinance No. 91-96 in their case. *Id.* Nonetheless, the SLO and Kamehameha Schools cases were argued and decided together by the Ninth Circuit below.

*nell* v. *City of San Jose*, 485 U.S. 1 (1988), and *Yee* v. *City of Escondido*, 503 U.S. 519 (1992), Pet. App. 57a-58a, the district court noted that, in stark contrast to rent-control ordinances that had withstood constitutional challenge, "absolutely nothing in Ordinance 91-96's regulatory scheme accounts for the many unique factors . . . which may affect the value of an individual parcel of real property at the time of renegotiation." *Id.* at 58a. As a result, the district court concluded that Ordinance No. 91-96 was fatally flawed because it did not guarantee "the lessor . . . a fair rate of return." *Id.* at 61a. *Second*, the district court determined that Ordinance No. 91-96 was unconstitutional because it permitted the "owner-occupant to charge a premium, in connection with the sale of a leasehold condominium with a below-market rate renegotiated lease rent, thereby operating to transfer value from the lessor to the lessee/seller." *Id.* at 65a. Relying on statements from this Court's decision in *Yee*, 503 U.S. at 530, the district court found that "the availability of the premium and the resulting transfer of wealth from the lessor to the lessee under Ordinance 91-96 violates the Taking[s] Clause." Pet. App. 65a.

b. A unanimous court of appeals affirmed. Pet. App. 3a. The court of appeals first set forth the governing legal standard which the City acknowledges is proper (Cond. Pet. 5): "A land use regulation . . . does not effect a taking if it substantially furthers a legitimate state interest and does not deny the landowner economically viable use of his land." Pet. App. 27a. The court of appeals correctly identified that the purpose underlying Ordinance No. 91-96 was "to provide renegotiated land lease rents 'which are affordable to condominium apartment owner-occupants and fair to lessors' and to 'maintain [affordable housing] for owner-occupants.'" *Id.* at 29a (quoting Ordinance No. 91-96).[3] Thereafter, the court

[3] The court of appeals also rejected the City's jurisdictional argument that Kamehameha Schools' regulatory takings claim was not ripe. Pet. App. 29a-30a.

of appeals concluded that Ordinance No. 91-96 constituted a regulatory taking because it "regulates the use of the lessors' property interests in a manner that does not substantially further the goal of creating affordable housing." *Id.* at 30a. Specifically, the court of appeals explained that because Ordinance No. 91-96 lacked a "mechanism that prevents lessees from capturing the net present value of the reduced land rent in the form of a premium, . . . [i]ncumbent owner occupants who sell to those who intend to occupy the apartment will charge a premium for the benefit of living in a rent controlled condominium." *Id.* As a result, the court of appeals determined that "[t]he price of housing ultimately will remain the same," and therefore, "the Ordinance will not substantially further its goal of creating affordable owner-occupied housing in Honolulu." *Id.*[4]

4. Following the court of appeals' decision, on January 22, 1998, a Bill was introduced in the City Council "relating to condominium lease rent renegotiation." Opp. App. 1a. The Bill acknowledges that "[t]wice previously the city has used the authority to approve ordinances intended to establish fair and reasonable renegotiated lease rents for condominium apartment lessees and land lessors," *id.*, and that "[b]oth ordinances were held unconstitutional by the federal courts," *id.* at 2a. The Bill, however, concludes that the infirmities identified by the federal court decisions "are not insurmountable" and that new rent-control provisions would "address constitutional issues cited by the federal courts in rejecting two previous ordinances on the subject." *Id.* That Bill passed first reading by the Council and is now pending before the Committee on Housing. *Id.* at 10a.

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[4] Because the district court and court of appeals both held that Ordinance No. 91-96 violated the Takings Clause, neither addressed Kamehameha Schools' remaining constitutional and state law claims. Pet. App. 65a n.19; *id.* at 31a n.7.

## ARGUMENT

The decision below raises no issue worthy of the Court's review with respect to Ordinance No. 91-96. The City admits that the court of appeals applied the proper legal standard to assess whether that Ordinance constituted an uncompensated regulatory taking. Cond. Pet. 5-6. Moreover, the City identifies no decision of this Court or of any other court that is in conflict with the court of appeals' decision. Although the City disputes the court of appeals' application of the unchallenged legal standard to the facts of this case, the court of appeals correctly concluded that Ordinance No. 91-96 did not "substantially advance" the governmental interest for which it was expressly enacted. Pet. App. 30a-31a. But, even if the court of appeals' application of the admittedly proper legal standard to the peculiar facts presented here were erroneous, the City's request for fact-intensive error correction is an inappropriate basis for review. See Sup. Ct. R. 10. That is especially true where, as here, members of the City Council already have taken steps to enact another rent-control ordinance designed to overcome the infirmities identified by the lower courts.

1. The City acknowledges that the "Ninth Circuit Court of Appeals correctly identified the standard applicable to [Kamehameha Schools'] challenge to Ordinance 91-96," Cond. Pet. 5: "A land use regulation . . . does not effect a taking if it substantially furthers a legitimate state interest and does not deny the landowner economically viable use of his land." Pet. App. 27a (citing *Dolan* v. *City of Tigard*, 512 U.S. 374, 385 (1994)). Given this concession, the City's subsequent suggestion that the "Ninth Circuit deviated from the established legal precedents," Cond. Pet. 7, is both curious and contrary to the numerous decisions from this Court setting forth precisely the same legal standard for the regulation of land use. See *Lucas* v. *South Carolina Coastal Council*, 505 U.S. 1003, 1016 (1992) ("As we have said on numerous

occasions, the Fifth Amendment is violated when a land-use regulation 'does not substantially advance legitimate state interests or denies an owner economically viable use of his land' ") (quoting *Agins* v. *Tiburon*, 447 U.S. 255, 260 (1980)) (emphasis omitted); *Nollan* v. *California Coastal Comm'n*, 483 U.S. 825, 834 (1987) (same); *United States* v. *Riverside Bayview Homes, Inc.*, 474 U.S. 121, 126 (1985) (same); *Village of Euclid* v. *Ambler Realty Co.*, 272 U.S. 365, 395-97 (1926) ("substantial relation" to legitimate governmental interests); cf. *Yee* v. *City of Escondido*, 503 U.S. 519, 534-38 (1992) (declining to address whether rent-control ordinance substantially advanced a legitimate state interest).

The City's confusion on this point appears to arise from its failure to distinguish between the two prongs of the test cited by the court of appeals. Whether Ordinance No. 91-96 "preserve[d] the lessor's right to a *reasonable return on its investment*," Cond. Pet. at 6, which is the focus of the City's argumentation, is relevant only to the second prong, which asks whether the owner has been denied "economically viable use of his land." Pet. App. 27a.[5] Although the district court ruled that Ordinance No. 91-96 failed under both prongs of the relevant takings analysis, Pet. App. 61a, 65a, the court of appeals expressly reserved ruling on the "economically viable use of the land" prong because it determined that Ordinance No. 91-96 failed "to substantially further a legitimate state interest." Pet. App. 31a n.7. Thus, the bulk of the City's

[5] Moreover, the City's string citation to cases from this Court simply does not support its conclusion that the Constitution requires, "at most" that lessors receive a "*reasonable return on* [*their*] *investment.*" Cond. Pet. 6 (citing cases). Instead, the cases cited by the City either support the Ninth Circuit's analysis, *see Riverside Bayview Homes*, 474 U.S. at 126 (requiring that a land use regulation "substantially advance legitimate state interests" (internal quotation marks omitted)), or are largely irrelevant to the issues presented, *see, e.g., Connolly* v. *Pension Benefit Guar. Corp.*, 475 U.S. 211, 213 (1986) (addressing constitutionality of the Multiemployer Pension Plan Amendments Act of 1980).

arguments about the court of appeals' supposed legal error are directed toward a ruling the court of appeals did not make.

In addition, the City is wrong to suggest that *Dolan* v. *Tigard* somehow lowered the level of scrutiny afforded a land-use regulation under the Takings Clause. Cond. Pet. 11. Instead, the *Dolan* Court reconfirmed the standards for assessing the constitutionality of such land-use regulations in general, 512 U.S. at 385, and then adopted a separate "rough proportionality" standard applicable to "adjudicative decision[s]" that involved permit conditions, *id.* If anything, that standard strengthened judicial review of the types of land-use restrictions at issue in that case, which are, in any event, different from those at issue here. In sum, there is no tension between the court of appeals' ruling with regard to Ordinance No. 91-96 and this Court's decision in *Dolan*.

The City fares no better in its efforts to identify a conflict between the court of appeals' decision and decisions of other lower courts. The only decision by a court of appeals discussed by the City—*Carson Harbor Village Ltd.* v. *City of Carson*, 37 F.3d 468 (9th Cir. 1994), overruled on other grounds by *WMX Techs., Inc.* v. *Miller*, 104 F.3d 1133 (9th Cir. 1997) (en banc), Cond. Pet. 9-10—is a decision by the same court of appeals that rendered the decision below, and therefore could create, at most, an intra-circuit conflict best resolved by the Ninth Circuit. See *Davis* v. *United States*, 417 U.S. 333, 340 (1974). But the *Carson* decision creates no such conflict because it expressly declined to reach the regulatory takings issues, which the plaintiff lacked standing to raise. 37 F.3d at 476-77. In any event, the *Carson* court observed, like the court of appeals in this case, that a rent control ordinance violates the Fifth Amendment if it " 'does not substantially advance legitimate state interests *or* denies an owner economically viable

use of his land.' " *Id.* at 473 (quoting *Lucas*, 505 U.S. at 1016).[6]

In short, the City has failed to identify any conflict between the decision below and the decisions of this Court or of any other court. See *Yee*, 503 U.S. at 537 (declining to review issue of whether rent-control ordinance constituted regulatory taking, in part, because "[t]he lower courts have not reached conflicting results").

2. Unable to identify any conflict among the courts, the City is left to argue that the Ninth Circuit improperly applied the correct legal standard to the peculiar features of Ordinance No. 91-96. Apart from the fact that such a determination is inappropriate for this Court's attention, see Sup. Ct. R. 10, the record reflects that the court of appeals' application of the law to the particular facts in this case was not only unexceptional but also entirely correct.

The City's claim to the contrary consists of a two-pronged attack. *First*, the City contends that the court of appeals misapplied the law by analyzing the *wrong* governmental interests. Cond. Pet. 7 ("The Ninth Circuit's analysis failed to recognize that the government has a legitimate interest in facilitating a healthy and stable housing market"). That claim is false. The court of appeals properly identified the relevant governmental interest by turning to and quoting directly from the "Findings and Purpose" section of Ordinance No. 91-96. See Pet. App.

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[6] The City quotes at length from *Carson*'s analysis of a rent-control provision which the *Carson* court concluded was constitutional under the "deferential," rational-basis standard applicable to "substantive due process challenge[s]," 37 F.3d at 472, Cond. Pet. 9-10. To pass muster under that deferential standard requires only that "a rational relationship exis[t] between the provisions and the purpose of the ordinance." 37 F.3d at 472. That analysis in no way conflicts with the court of appeals' conclusion in this case that Ordinance No. 91-96 failed to satisfy the more demanding standard applicable to challenges under the Takings Clause. *See* Pet. App. 30a.

29a. Thus, the court of appeals correctly concluded that: "The City enacted the Ordinance to provide negotiated land lease rents 'which are affordable to condominium apartment owner-occupants and fair to lessors' and to 'maintain [affordable housing] for owner occupants.'" *Id.* (quoting Ordinance No. 91-96).

*Second*, the City argues that the court of appeals erred by concluding that Ordinance No. 91-96 "serves *no* legitimate state interest," Cond. Pet. 7 (emphasis added), and that it "erroneously jumped to the conclusion that *no* legislative purpose could be advanced by the ordinance," *id.* at 9 (emphasis added). The court of appeals did no such thing. Rather, it properly held that Ordinance No. 91-96 effected a regulatory taking because it did not "*substantially further* its goal of creating affordable owner-occupied housing." Pet. App. 30a (emphasis added). In support of that more limited conclusion, the court of appeals relied on language from this Court's decision in *Yee*, Pet. App. 28a, and determined that the "absence of a mechanism that prevents lessees from capturing the net present value of the reduced land rent in the form of a premium" means that "[i]ncumbent owner occupants who sell to those who intend to occupy the apartment will charge a premium for the benefit of living in a rent controlled condominium." Pet. App. 30a. As a result, the "price of housing ultimately will remain the same." *Id.* Accordingly, the court of appeals was correct in concluding that Ordinance No. 91-96 failed to "substantially advance" its stated goal of creating affordable housing.

3. Finally, even if the court of appeals had misapplied the admittedly proper legal standard—which it did not—the particularized application of the undisputed standard to Ordinance No. 91-96 does not present an issue worthy of this Court's review. See Sup. Ct. R. 10 ("A petition for a writ of certiorari is rarely granted when the asserted error consists of erroneous factual findings or the misapplication of a properly stated rule of law"). Indeed, re-

evaluation of the facts by this Court would be especially unwarranted as legislation designed to regulate condominium lease rent renegotiation in a manner that members of the City Council contend will avoid the "constitutional infirmities" identified by the lower federal courts already has been introduced in the City Council. See Opp. App. 2a. As a result, not only would a narrow, fact-bound decision by this Court have little or no application nationwide, but also it might very well have no effect in the City and County of Honolulu.

## CONCLUSION

For the foregoing reasons, the City's conditional cross-petition for a writ of certiorari should be denied.

Respectfully submitted,

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August 13, 1998

# APPENDICES

# APPENDICES

## APPENDIX A

[City Seal]

CITY COUNCIL
CITY AND COUNTY OF HONOLULU
Honolulu, Hawaii

Bill 3 (1998)

A BILL FOR AN ORDINANCE

RELATING TO CONDOMINIUM LEASE RENT RENEGOTIATION.

BE IT ORDAINED by the People of the City and County of Honolulu:

SECTION 1. The council finds that:

(1) Several leasehold condominium projects have been undergoing lease rent renegotiations involving many condominium lessee homeowners who are senior citizens on fixed incomes unable to afford the dramatically escalated lease rents and are facing a crisis due to the possible loss of their homes;

(2) Many other leasehold condominium projects in communities around Oahu will soon be subject to their first apartment lease rent renegotiations in the near future;

(3) The renegotiated lease rents should be fair and reasonable to both condominium apartment lessees and land lessors;

(4) Section 46-1.5(20), Hawaii Revised Statutes, authorizes the city to regulate the "renting, subletting, and rental conditions of property for places of abode by ordinance";

(5) Twice previously the city has used the authority to approve ordinances intended to establish fair and reasonable renegotiated lease rents for condominium apartment lessees and land lessors;

(6) Both ordinances were held unconstitutional by the federal courts;

(7) Review of the court decisions, however, reveals that the constitutional infirmities of the ordinances are not insurmountable;

(8) The state has a statute establishing the maximum renegotiated lease rent for leasehold one- and two-family lots;

(9) The statute, enacted in 1975, was held to be constitutional by a state circuit court in 1978; and

(10) An ordinance similar to the statute also should withstand a constitutional challenge as has been the case with the city's mandatory leasehold condominium conversion ordinance which is similar to the earlier state statute for mandatory conversion of leasehold single family residences.

The purpose of this ordinance is to establish provisions for the determination of the maximum allowable renegotiated lease rent for a condominium apartment of an owner-occupant. This ordinance is based on the state statute establishing the maximum renegotiated lease rent for leasehold one- and two-family lots. This ordinance also includes provisions intended to address constitutional issues cited by the federal courts in rejecting two previous ordinances on the subject.

SECTION 2. The Revised Ordinances of Honolulu 1990 is amended by adding a new Chapter to be appropriately designated and to read as follows:

"CHAPTER ——
MAXIMUM CONDOMINIUM RENEGOTIATED LEASE RENT

Sec. —-1.1 Definitions.

For the purpose of this chapter:

"Apartment" means the same as defined under HRS Chapter 514A.

"Apartment lease" means an apartment owner-occupant's lease to the apartment. The term includes a lease of an interest in the condominium project land upon which the apartment is situated.

"Apartment owner" means a person or the persons jointly or in common holding a leasehold interest in a residential apartment.

"Apartment owner-occupant" means an apartment owner who on the renegotiation date of the apartment lease occupies the apartment. An apartment owner shall be deemed to occupy an apartment if, on the renegotiation date, the apartment is the principal place of residence and under the possessory control of the apartment owner.

"Condominium project" means a building within a condominium property regime.

"Condominium project land" means the land on which a condominium project is situated.

"Department" means the department of housing and community development.

"Land owner" means the person holding a leased fee interest in condominium project land.

"Lease" means a lease or sublease, including any sandwich lease, affecting a residential apartment. A "sandwich lease" means any sublease in the chain of title between the land owner's interest in the land and the apartment lease.

"Lease rent" means the rent payable by an apartment owner-occupant to a lessor for the leasehold interest in a residential apartment.

"Lessee" means any person to whom an interest in condominium project land is leased or subleased.

"Lessor" means any person who leases or subleases an interest in condominium project land to another person.

"Offsite improvements" of a condominium project mean all physical improvements:

(1) Which are constructed or placed off the condominium project land; and

(2) Which are to be used in common by occupants of all lands adjoining the improvements or by occupants of all lands for whose benefit the improvements have been constructed or placed.

"Onsite improvements" of a condominium project mean all physical improvements;

(1) Which are constructed or placed on the condominium project land; and

(2) Which are for the benefit of apartment owners and other lessees in the condominium project.

"Onsite improvements" include, but are not limited to, dwelling units, garages, stairs, walkways, driveways, walls, trees, shrubs, landscaping, and pools.

"Renegotiated lease rent" means the annual lease rent determined for each renegotiation date applicable to an apartment lease.

"Renegotiation date" means the date on which a renegotiated lease rent is to take effect.

"Residential apartment" means an apartment located in a condominium project and used for residential purposes. The term does not include the following:

(1) An apartment used for commercial purposes;

(2) An apartment used as a time share unit or transient vacation unit, as defined under Chapter 21, Article 9; or

(3) Any parking, recreational, or other nonresidential condominium apartment.

Sec. — -1.2 Applicability of chapter.

(a) This chapter:

(1) Applies to every apartment lease of a residential apartment of an apartment owner-occupant that contains provisions for the renegotiation of lease rent. This chapter shall apply whether the apartment lease was executed before July 1, 1998 or after June 30, 1998. This chapter also shall apply to lease rent renegotiations that are concluded after July 1, 1998; and

(2) Sets a maximum allowable renegotiated lease rent for the residential apartment of an owner-occupant.

(b) This chapter shall not be construed as setting a maximum lease rent for a residential apartment that is not owned by an apartment owner-occupant.

This chapter also shall not be construed as requiring the renegotiation of a lease rent which was renegotiated before July 1, 1998.

Sec. — -1.3 Renegotiation provisions.

(a) Every apartment lease shall include or be deemed to include the following provisions:

(1) Renegotiation of lease rent shall not occur more frequently than every 15 years after each renegotiation date; provided that the first renegotiation shall not be scheduled before the 15th year following the initial date of the lease; and

(2) After any renegotiation, the renegotiated lease rent for the apartment lease shall not exceed the maximum allowable under subsection (b).

(b) On a renegotiation date, the renegotiated lease rent payable for an apartment lease to a residential

apartment in a condominium project shall not exceed the dollar amount derived as follows:

(1) First, by multiplying the land owner's basis by four percent; and

(2) Then, by multiplying the result of subdivision (1) by the common interest appertaining to the residential apartment. The result of this subdivision shall be the maximum allowable annual lease rent payable for the apartment lease until the next renegotiation date.

(c) For the purpose of this section, "land owner's basis" means the fair market value of the condominium project land, valued on the applicable renegotiation date as if the fee title in the land was unencumbered, and excluding the following:

(1) The value of onsite improvements; and

(2) If applicable, the relevant apartment owner-occupant's share of the sum of the following:

(A) The current replacement cost of existing offsite improvements, attributable to the condominium project, which were paid for or contributed by apartment owners; and

(B) Overhead and profit not exceeding 20 percent of that cost.

(d) In the event the parties to a lease are unable to agree on a renegotiated lease rent, the mandatory arbitration provisions of HRS Section 516D-12 shall apply.

Sec. —-1.4 Lessor sharing of lease rent payments.

If more than one lessor has an interest in the condominium project land, they shall share in the lease rent payments from the apartment leases in accordance with their respective interests in the condominium project land.

Notwithstanding any contrary provision in any contract or lease, a developer or other person entitled to share in the lease rent payments shall share in such payments according to the terms of any applicable agreement by those entitled, or in the absence of such agreement, pursuant to HRS Chapter 658.

Sec. —-1.5 Enforcement.

(a) Any person violating any provision of this chapter shall be subject to a civil fine not exceeding $500.00 for each violation.

(b) The department of housing and community development shall enforce this chapter. Any person may request the department to investigate any alleged violation of this chapter. Or, the department on its own initiative may investigate any alleged violation.

(c) Upon receipt of a written request by a person to investigate an alleged violation of this chapter or upon its own initiative, the department shall conduct an investigation. If finding that a violation has occurred, the department shall attempt an informal correction of the violation. If the violation cannot be informally corrected or if the person requesting the investigation or the alleged violator requests an agency hearing, the department shall:

(1) Hold an agency hearing in accordance with the contested case procedures of HRS Chapter 91; and

(2) Issue an appropriate decision and order. If finding that a violation has occurred, the department may order the violator to do any or all of the following:

(A) Cease and desist from the violation;

(B) Correct the violation;

(C) Pay to a lessor or lessee any amount due and owing as specified in this chapter. An "amount due and owing" includes excessive lease rent paid by an apartment owner-occupant or insufficient lease rent paid to a lessor; or

(D) Pay the civil fine imposed under subsection (a).

(d) The department may institute a civil action in any court of competent jurisdiction for the enforcement of any decision and order issued pursuant to this section. If finding that a violation has not occurred, whether before or after an agency hearing, the department shall so notify the alleged violator and, if any, the person who requested the investigation. The notification shall be in writing.

Sec. — -1.6 Rules.

The department of housing and community development may adopt rules necessary to implement this chapter. The rules, if any, shall be adopted in accordance with HRS Chapter 91."

SECTION 3. Chapter 39, Revised Ordinances of Honolulu 1990, is repealed.

SECTION 4. This ordinance shall take effect on July 1, 1998.

INTRODUCED BY:

/s/ Andy Mirikitani

/s/ John Henry Felix
Councilmembers

DATE OF INTRODUCTION:

January 22, 1998
Honolulu, Hawaii

APPROVED AS TO FORM AND LEGALITY:

_____

Deputy Corporation Counsel

APPROVED this —— day of ——, 1998.

_____

JEREMY HARRIS, Mayor
City and County of Honolulu

**APPENDIX B**

Document: B3. 98 (Page 1)

DATA FOR THIS RECORD AS OF 07/24/98

Bill 3, 1998
Introduced: 01/22/98 by: ANDY MIRIKITANI
Re: CONDOMINIUM LEASE RENT RENEGOTIATION CONDOMINIUM LEASE RENT. CONDOMINIUMS. LEASE RENT. MIRIKITANI, ANDY. RENEGOTIATION.
Referred to HS
File Name: B3.98X

Title:

A BILL FOR AN ORDINANCE RELATING TO CONDOMINIUM LEASE RENT RENEGOTIATION.

Gist:

To establish provisions for the determination of the maximum allowable renegotiated lease rent for a condominium apartment of an owner-occupant.

Comments:

Bill referred to the Human Services Committee (previously Housing Committee). (CC-234 dated 5/27/98)

Bill History:

01/28/98 COUNCIL 1ST
Bill passed First Reading and referred to the Committee on Housing.

| | |
|---|---|
| BAINUM, DUKE | Y |
| DESOTO, JOHN | N |
| FELIX, JOHN HENRY | Y |
| HANNEMANN, MUFI | Y |

| | |
|---|---|
| HOLMES, STEVE | Y |
| KIM, DONNA MERCADO | Y |
| MANSHO, RENE | Y |
| MIRIKITANI, ANDY | Y |
| YOSHIMURA, JON | Y |

Related Communications:

CC 32, 1998 by: JOHN DESOTO, CHAIR
Reminding T. Phyllis Zerbe of Councilmember Felix's request for a list of property owners who comprise the Small Landowners Association and the number of units per property owner.

M 128, 1998 by: ROCHELLE ARQUETTE
KAMEHAMEHA SCHOOLS/BISHOP ESTATE
Opposing Bill 3 as an unconstitutional rent control proposal.

M 131, 1998 by: T. PHYLLIS ZERBE
SMALL LANDOWNERS ASSOCIATION
Opposing Bill and all similar proposed legislation.

M 133, 1998 by: T. PHYLLIS K. ZERBE
Opposing Bill.

M 253, 1998 by: JAMES K. MEE
Informing Council that the statement that a similar state statute was held constitutional is wrong because the lower court decision referred to was vacated by the Hawaii Supreme Court.